

No. 11881

IN THE  
United States Circuit Court of Appeals  
FOR THE NINTH CIRCUIT

---

MARLBOROUGH CORPORATION,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

---

**TRANSCRIPT OF RECORD**

Upon Appeal From the District Court of the United States  
for the Southern District of California  
Central Division

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**FILED**

JUN 18 1948

**PAUL B. O'BRIEN,**  
CLERK



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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italics; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in italics the two words between which the omission seems to occur.]

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Los Angeles 12, Calif. [1\*]

\*Page number appearing at foot of Certified Transcript.

In the District Court of the United States in and for the  
Southern District of California

Central Division

Civil No. 3727-H

MARLBOROUGH CORPORATION

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT FOR RECOVERY OF FEDERAL  
INCOME TAXES ILLEGALLY ASSESSED  
AND COLLECTED

Comes now the plaintiff, and for cause of action against  
defendant alleges:

I.

That plaintiff is, and at all times herein mentioned was,  
a corporation organized and existing under and by virtue  
of the laws of the State of California, duly qualified to  
transact business therein and having its principal place  
of business and office at 735 Roosevelt Building, Los  
Angeles, California, and within the Sixth Internal Revenue  
Collection District of said State of California.

II.

JURISDICTION

The taxes sought to be recovered in this proceeding  
were collected by Nat Rogan, Collector of Internal Rev-  
enue, for the Sixth District of California, acting for and

on behalf of defendant, and whereas Nat Rogan is [2] no longer in office, jurisdiction of this action lies in this District Court under the provisions of Section 3772 of 1122(c) of the Revenue Act of 1926, and Judicial Code, Section 24 (Title 28, USCA Section 41).

### III.

On or before the time required by law, plaintiff filed its income tax return on form 1120 for its taxable year ended August 31, 1939, showing a net income of \$37,337.55, and concurrently paid to the Collector of Internal Revenue for the Sixth District of California the sum of \$6,279.36 representing its income tax liability for the aforesaid taxable year.

### IV.

(a) Thereafter, and by letter dated July 7, 1942, (Symbols LA:IT:90D:PB), the Commissioner of Internal Revenue asserted a deficiency in Federal income taxes against the plaintiff for the taxable year ended August 31, 1939, in the amount of \$3,389.55 plus interest for the asserted late payment thereof.

(b) The entire amount of the deficiency in taxes claimed to be due for the fiscal year ended August 31, 1939, was based upon the assertion of liability for the surtaxes under Section 102 of the Revenue Act of 1938.

(c) Thereafter and on or about July 31, 1942, plaintiff paid to Nat Rogan, Collector of Internal Revenue at Los Angeles, on account of said asserted deficiency in income



taxes, the amount of \$3,942.46 which was applied as follows:

On the alleged deficiency for the year ended August 31, 1939, under Section 102 of the Revenue Act of 1938	\$3,389.55
Interest on said alleged deficiency	551.24
Overpayment for year ended August 31, 1939	1.67
	<hr/>
Total taxes and interest paid	\$3,942.46
	<hr/> <hr/>

### V.

The Federal income tax deficiency paid by and collected from the plaintiff by the Collector of Internal Revenue, Nat Rogan, for the taxable year ended August 31, 1939, was illegally assessed and collected from the [3] plaintiff and was in excess of the amount legally due and owing to the United States from the plaintiff by reason of the following facts:

(a) Plaintiff was neither formed nor availed of, either during the taxable year ended August 31, 1939, or any other taxable year, for the purpose of preventing the imposition of surtaxes upon its shareholders as provided by Section 102 of the Revenue Act of 1938 and/or Section 102 of the Internal Revenue Code.

(b) Plaintiff did not, either during the taxable year ended August 31, 1939, or during any other taxable year accumulate, or permit its earnings and/or profits to accumulate in excess of the reasonable needs of its business.

(c) That any and/or all of plaintiff's earnings and/or profits which have been accumulated were necessary to the conduct and future needs of plaintiff's business, and none of its earnings and/or profits were accumulated or withheld from the payment of dividends for the purpose of



avoiding the imposition of surtaxes upon plaintiff's shareholders. The purposes for which the earnings and/or profits of plaintiff's business were accumulated were, among others, as follows:

(1) A large part of the useful lives of the assets used in plaintiff's business, particularly its buildings, was exhausted; many of such assets were in a deteriorated condition, outmoded and insufficient in capacity and facilities for the proper conduct of plaintiff's business, and required replacement as soon as financial and building conditions warranted.

(2) The principal working assets of a school business consist of buildings and ground facilities, the acquisition and replacement of which require the accumulation of funds and reserves over long periods of time and the use of accumulated earnings and profits to retire indebtedness incurred therefor.

(3) Because of changes in the California building codes and laws, replacement of certain of plaintiff's school buildings required the expenditure of almost double the amounts originally expended in erecting such buildings. Even with the accumulations of resources available during the years in question, plaintiff would be required to borrow large sums in order to make such replacements. The distribution of such resources as dividends would have not only increased the necessary borrowing beyond the limits of financial safety but, [4] because of the inadequate security afforded by private school buildings would have put plaintiff in a position where it could not obtain the funds required for such replacements at all.

(4) During the years in question it was definitely known that the lease under which the business had formerly been operated by a lessee using her own working

capital was to be terminated within a year. Plaintiff therefore undertook to accumulate working capital sufficient to operate the business on its own behalf.

(5) Changing conditions and shifts in the population of Los Angeles made it advantageous and a business necessity to move rather than rebuild the school at its then location. The funds required to consummate such a change substantially exceeded the amounts which plaintiff could expect to borrow plus accumulations on hand during the years in question, and required additional accumulations of earnings and profits during subsequent years.

## VI.

On or about August 7, 1943, and within two years of the date of payment of the Federal income tax deficiency, erroneously and illegally collected as aforesaid, plaintiff filed its claim for refund on Form 843 for the taxable years ended August 31, 1939, a copy of which is attached hereto and marked Exhibit "1." Said claim set forth, under oath, the grounds for refund hereinabove relied upon and facts sufficient to apprise the defendant and Commissioner of Internal Revenue of the exact basis of the claim. On November 5, 1943, the Commissioner of Internal Revenue mailed, by registered mail, his notice of disallowance of said claim, excepting, however, that the Commissioner determined an overassessment of \$41.98 for the taxable year ended August 31, 1939, due to the exclusion from plaintiff's gross income of the amount of certain nontaxable bond interest erroneously reported by plaintiff in its return for said year.

## VII.

By reason of the above facts, defendant erroneously and illegally collected \$3,389.55 in income taxes from plaintiff,

together with \$552.91 interest thereon for the asserted late payment of such tax, all of which [5] defendant has refused and still does refuse to repay or refund to plaintiff notwithstanding plaintiff has made demands and claims therefor according to law.

For a second and separate cause of action against defendant, plaintiff further alleges:

I.

The allegations contained in paragraphs I and II of plaintiff's first cause of action are hereby fully and completely incorporated by reference in this cause of action.

II.

On or before the time required by law, plaintiff filed its income tax return on form 1120 for its taxable year ended August 31, 1940, showing a net income of \$21,-870.32 and concurrently paid to the Collector of Internal Revenue for the Sixth District of California the sum of \$2,535.91 representing its income tax liability for the said taxable year.

III.

(a) Thereafter and by letter dated July 7, 1942 (Symbols LA:IT:90D:PB), the Commissioner of Internal Revenue asserted a deficiency in Federal income taxes against plaintiff for the taxable year ended August 31, 1940, as follows:

Income tax under Section 13, Internal Revenue Code	\$ 924.46
Surtax under Section 102, Internal Revenue Code	5,112.03
	<hr/>
Total deficiency asserted	\$6,036.49
	<hr/> <hr/>

(b) The deficiency in taxes asserted for the fiscal year ended August 31, 1940, was based upon:

(1) The disallowance of depreciation deducted in plaintiff's return for said year in the amount of \$4,538.18 resulting in an increase in the income tax liability under Section 13 of the Internal Revenue Code in the amount of \$924.46;

(2) The assertion of liability for surtaxes under Section 102 of the Internal Revenue Code in the amount of \$5,112.03 resulting in a total additional tax deficiency asserted against the plaintiff for said taxable year in the amount of \$6,036.49. [6]

(c) Thereafter and on or about July 31, 1942, plaintiff paid to Nat Rogan, Collector of Internal Revenue at Los Angeles, on account of said asserted deficiency in taxes, the amount of \$6,658.99, which was applied as follows:

On the alleged deficiency for the year ended August 31, 1940, under Section 13, Internal Revenue Code	\$ 924.46
On the alleged deficiency for the year ended August 31, 1940, under Section 102, Internal Revenue Code	5,112.03
Interest on said alleged deficiencies	619.52
Overpayment for the year ended August 31, 1941	2.98
	<hr/>
Total taxes and interest paid	\$6,658.99
	<hr/> <hr/>

#### IV.

The Federal income tax deficiencies paid by and collected from the plaintiff by the Collector of Internal

Revenue, Nat Rogan, for the taxable year ended August 31, 1940, were illegally assessed and collected from the plaintiff, and were in excess of the amount legally due and owing to the United States from the plaintiff by reason of the following facts:

(a) Plaintiff was neither formed nor availed of, either during the taxable year ended August 31, 1940, or any other taxable year, for the purpose of preventing the imposition of surtaxes upon its shareholders as provided by Section 102 of the Revenue Act of 1938 and/or Section 102 of the Internal Revenue Code.

(b) Plaintiff did not, either during the taxable year ended August 31, 1940, or during any other taxable year, accumulate or permit its earnings and/or profits to accumulate in excess of the reasonable needs of its business.

(c) That any and/or all of plaintiff's earnings and/or profits which may have been accumulated were necessary to the conduct and future needs of plaintiff's business, and that none of its earnings and/or profits were accumulated or withheld from the payment of dividends for the purpose of avoiding the imposition of surtaxes upon plaintiff's shareholders. The purposes for which [7] the earnings and/or profits of plaintiff's business were accumulated were, among others, as follows:

(1) A large part of the useful lives of the assets used in plaintiff's business, particularly its buildings, was exhausted; many of such assets were in a deteriorated condition, outmoded and insufficient in capacity and facilities for the proper conduct of plaintiff's business, and required replacement as soon as financial and building conditions warranted.



(2) The principal working assets of a school business consist of buildings and ground facilities, the acquisition and replacement of which require the accumulation of funds and reserves over long periods of time and the use of accumulated earnings and profits to retire indebtedness incurred therefor.

(3) Because of changes in the California building codes and laws, replacement of certain of plaintiff's school buildings required the expenditure of almost double the amounts originally expended in erecting such buildings. Even with the accumulations of resources available during the years in question, plaintiff would be required to borrow large sums in order to make such replacements. The distribution of such resources as dividends would have not only increased the necessary borrowing beyond the limits of financial safety but, because of the inadequate security afforded by private school buildings would have put plaintiff in a position where it could not obtain the funds required for such replacements at all.

(4) During the years in question it was definitely known that the lease under which the business had formerly been operated by a lessee using her own working capital was to be terminated within a year. Plaintiff therefore undertook to accumulate working capital sufficient to operate the business on its own behalf.

(5) Changing conditions and shifts in the population of Los Angeles made it advantageous and a business necessity to move rather than rebuild the school at its then location. The funds required to consummate such a

change substantially exceeded the amounts which plaintiff could expect to borrow plus accumulations on hand during the years in question, and required additional accumulations of earnings and profits during subsequent years. [8]

(d) In disallowing the amount of \$4,538.18 as a deduction for depreciation and/or obsolescence sustained by plaintiff for the fiscal year ended August 31, 1940, the Commissioner of Internal Revenue computed his allowance for depreciation upon plaintiff's auditorium building, upon the basis of a useful life of forty (40) years, whereas such building had and will have a useful life in plaintiff's business of not to exceed ten (10) years from and after the close of the taxable year ended August 31, 1940. In assessing and collecting the taxes in question upon the basis of the useful life determined by the Commissioner of Internal Revenue, plaintiff was erroneously and illegally denied the reasonable allowance for exhaustion, wear and tear and obsolescence allowed by law.

## V.

On or about August 7, 1943, and within two years of the date of payment of the Federal income tax deficiencies, erroneously and illegally collected as aforesaid, plaintiff filed its claim for refund on form 843 for the taxable year ended August 31, 1940, a copy of which is attached hereto and marked Exhibit "2." Said claim set forth, under oath, the grounds for refund hereinabove relied upon and facts sufficient to apprise the defendant and Commissioner of Internal Revenue of the exact basis

of the claim. On November 5, 1943, the Commissioner of Internal Revenue mailed, by registered mail, his notice of disallowance of said claim, excepting, however, that the Commissioner of Internal Revenue determined an over-assessment of \$85.75 for the taxable year ended August 31, 1940, due to the exclusion from plaintiff's gross income of the amount of certain nontaxable bond interest erroneously reported by plaintiff in its return for said year.

## VI.

By reason of the above facts, defendant erroneously and illegally collected \$6,036.49 in income taxes from plaintiff together with \$622.50 interest thereon for an asserted late payment of such tax, all of which defendant has refused and still does refuse to repay or refund to plaintiff, notwithstanding plaintiff has made demands and claims therefor according to law. [9]

Wherefore, plaintiff prays this Honorable Court for judgment that the plaintiff has overpaid its liability for income taxes and interest for the taxable year ended August 31, 1939, in the amount of \$3,942.46 and for the taxable year ended August 31, 1940, in the amount of \$6,658.99; that plaintiff have and recover from defendant the total amount of \$10,601.45 plus interest thereon from the date of overpayment as provided by law; and for such further relief as may be meet and just.

THOMAS R. DEMPSEY

ARTHUR H. DEIBERT

WILLIAM L. KUMLER

Attorneys for Plaintiff [10]

[Verified.] [11]

\* \* \* \* \*

[Endorsed]: Filed Jun. 28, 1944. [53]



[Title of District Court and Cause]

ANSWER

Comes now the defendant in the above-entitled action, and in answer to plaintiff's complaint admits, denies and alleges:

FIRST CAUSE OF ACTION

In answer to the first cause of action of plaintiff's complaint, defendant:

I.

Admits the allegations contained in Paragraph I thereof;

II.

Admits the allegations contained in Paragraph II thereof;

III.

Admits the allegations contained in Paragraph III thereof;

IV.

Admits the allegations contained in Paragraph IV thereof;

V.

Denies the allegations contained in Paragraph V thereof; [54]

VI.

Admits the allegations contained in Paragraph VI thereof, except that defendant denies that the income tax deficiency there referred to was erroneously and/or illegally collected.

## VII.

Denies the allegations contained in Paragraph VII thereof, except that defendant admits that the alleged not [E.N.F.] overpayment referred to has  $\wedge$  been repaid or refunded to the plaintiff.

## SECOND CAUSE OF ACTION

In answer to the second cause of action of plaintiff's complaint, defendant:

## I.

Admits the allegations contained in Paragraph I thereof;

## II.

Admits the allegations contained in Paragraph II thereof;

## III.

Admits the allegations contained in Paragraph III thereof;

## IV.

Denies the allegations contained in Paragraph IV thereof.

## V.

Admits the allegations contained in Paragraph V thereof, except that defendant denies that the alleged overpayment therein referred to was erroneously and/or illegally collected.

## VI.

Denies the allegations contained in Paragraph VI thereof, except that defendant admits that the claimed overpayment referred to has not been repaid or refunded to the plaintiff.

Wherefore, having fully answered, defendant prays that it be hence dismissed with its costs in this behalf expended.

CHARLES H. CARR

United States Attorney

E. H. MITCHELL and

GEORGE M. BRYANT

Asst. United States Attys.

EUGENE HARPOLE

Spec. Atty., Bur. Int. Rev.

By E. H. Mitchell

Attorneys for Defendant [55]

[Affidavit of Service by Mail.]

[Endorsed]: Filed Oct. 30, 1944. [56]

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[Title of District Court and Cause]

STIPULATION AFTER PRE-TRIAL  
CONFERENCE

The above-entitled proceeding having come on for pre-trial conference at 2:00 p. m. June 27, 1946, and counsel for the respective parties having stated their respective positions with respect to the issues raised in the cause, and the Court having decided to view the subject premises at 5029 West Third Street, Los Angeles, California, and the conference having adjourned thereto for the purpose of acquainting the Court with the subject premises but not for the purpose of taking testimony with respect thereto; it is Stipulated by counsel for the respective parties that in viewing the subject premises the Court inspected the following:

(1) The principal's office, including furniture and furnishings therein;

(2) The financial office, including lockers built therein;

(3) The entrance hall, including furnishings and furniture therein;

(4) The vice-principal's office;

(5) The living room, including the furnishings and furniture therein; [57]

(6) The main office, including the furnishings therein;

(7) The academic vice-principal's office, including the furniture and furnishings therein;

(8) The corridors on the first floor of the west wing of the main building;

(9) The large library on the first floor of the main building, including the shelves and stacks;

(10) The students' office, including the counter and furniture therein;

(11) Room B, classroom;

(12) The senior high art department, including the places where partitions had been removed and Celotex wall covering installed;

(13) The junior high art room, including the plumbing, lockers, cupboards and linoleum;

(14) The chemistry laboratory, including the equipment therein;

(15) A corridor on the second floor of the main building;

(16) A classroom on the second floor of the main building;

(17) The biology laboratory, including the lockers therein;

(18) Classroom M, junior high science room, including lighting fixtures therein;

(19) Various classrooms on the second floor of the west wing of the main building, including the furnishings and fixtures therein;

(20) Room 5, formerly constituting two rooms, including lockers and shelves built in;

(21) The reading room, formerly constituting two rooms, also the linoleum therein;

(22) Rooms 3 and 4;

(23) The lavatory on the second floor of the main building, formerly consisting of three small bathrooms;

(24) The corridor in the west wing of the second floor of the main building;

(25) The junior high library together with an open-air deck outside, and the condition of the exterior paint at this location; [58]

(26) Returning through the junior high library, the Court proceeding to Room 6, which had formerly been a bedroom;

(27) Room 7, which had formerly been two bedrooms;

(28) Room 8, which had formerly been three bedrooms, a bath and closet;

(29) The student council room, including the furniture and furnishings therein;

(30) Mrs. Overton's room, including the furnishings therein;

(31) Room 15, which formerly had been a bedroom;

(32) The Court then proceeded to the third floor of the south wing of the main building, where a storage attic and former servants' quarters were inspected. The Court also inspected a small balcony on the south wing of the building facing northerly across the patio toward the auditorium. The Court then returned to the southeast end of the corridor on the second floor;

(33) Room 16, in the east wing, second floor, being a room for resident teachers, including the furnishings therein;

(34) Room 17, in the east wing, second floor, together with the furnishings and furniture therein;

(35) A room in the east wing, second floor, containing the type of white, painted, wood furniture which was removed when the teachers' wing was refurnished,

(36) The vocal music studio;

(37) The junior assembly room which had once been a library;

(38) The gymnasium, showing the unfurnished portions where the wall was never sealed. This was being remodeled at the time of the inspection;

(39) The showers and dressing rooms adjacent to the gymnasium;

(40) The Court then proceeded to inspect the athletic fields, including basketball courts, tennis courts, volleyball courts, and took note of the limits upon the land available for additions to such facilities;

(41) The Court then entered the auditorium building through the south entrance, and, passing northerly in the corridor on the east side of the building, inspected the classrooms on the east side of the corridor.



(42) The Court then inspected the senior high assembly room in the [59] auditorium which is used both for assembly and study, and also inspected the stage where small productions can be given.

(43) From the auditorium the Court passed to the music building, where piano instruction is given and where two rooms had been thrown together to form a supply room. In this building the Court also inspected the music department office and the choir room, taking note of the condition of the linoleum.

(44) The Court then briefly inspected Room O, used for textile work;

(45) The Court then passed through the kitchens; the main pantry, where a freezing unit had been installed in the old icebox, and inspected the servants' hall and dining room.

(46) The Court then proceeded to the two dining rooms, inspected the furnishings and took note of the condition of the carpets, which appeared particularly worn at and near entrances to the rooms.

(47) The Court then inspected the main entrance hall rugs which had been laid in 1941.

(48) The Court finally inspected the locale of the archery range.

Upon concluding the foregoing inspection, the Court adjourned the conference.

Dated: July 9, 1946.

\* \* \* \* \*

[Endorsed]: Filed Jul. 10, 1946. [60]

[Title of District Court and Cause]

### JOINT PRE-TRIAL MEMORANDUM

This is an action to recover a refund of a corporate surtax in the sum of \$10,601.45, tax and interest, together with interest thereon at the rate prescribed by law, which tax and interest were assessed and collected for the taxpayer's fiscal years ending August 31, 1939, and August 31, 1940.

Originally the plaintiff claimed two grounds for its desired recovery. It has abandoned the claims based upon depreciation (obsolescence). This abandonment reduces the total amount prayed for by \$924.46, together with such portion of the interest of \$619.52, paid for 1940, as may be allocated to the said \$924.46.

Plaintiff's remaining cause of action is based upon taxes and interest assessed against it by the Commissioner of Internal Revenue for its fiscal years ending August 31, 1939 and 1940, under the provisions of Section 102, Internal Revenue Code.

The case was tried in full before Judge Hollzer during his lifetime and was under submission to him at the time of his death. Stipulations of Fact have been entered into and were presented to the court at the previous trial. Considerable testimony was taken and the same has been reported and transcribed. Counsel for plaintiff and defendant are of the opinion that the court may now be fully advised of the facts in this case by the submission of the case upon the documentary evidence, the Stipulations of Fact and the transcript of the testimony of witnesses in the previous trial, together with all the pleadings and briefs which are a part of the record of this cause.

It is believed, however, that since the ultimate decision in this case must be determined by the court's opinion



as to the credibility to be accorded to the witnesses Eugene Overton and Georgia Overton, that the court may feel it advisable to examine these two witnesses. Counsel therefore are prepared now to submit the case upon the evidence and pleadings as aforesaid, with the provision that the court shall have the power and right to examine the two witnesses mentioned herein and for counsel thereafter to examine the said witnesses, but such examination to take place only in the event that the court decides to re-examine said witnesses.

### STATEMENT OF THE FACTS

During the taxable years in question the plaintiff was engaged in the business of holding and renting school property to a school known as Marlborough School for Girls, operated by Ada Blake. The property is located at 5029 West Third Street, between Van Ness and Rossmore Streets, in the City of Los Angeles, State of California, and has a frontage of 150 feet on Third Street and 700 feet on Rossmore. The questions presented to the court are: Whether the corporation was availed of for the purpose of avoiding the imposition of surtax upon its stockholders; and, whether the accumulations set forth in the Stipulations of Fact were unreasonable and in excess of the needs of plaintiff's business.

The pertinent statutes and regulations and the case law involved have been presented in full in counsels' preliminary memoranda and the briefs filed in this cause.

Respectfully submitted,

\* \* \* \* \*

A True Copy. Attest, etc., Mar. 24, 1948. Edmund L. Smith, Clerk U. S. District Court, Southern District of California; by Theodore Hocke, Deputy. [Seal]

[Endorsed]: Filed Jun. 27, 1946.

[Title of District Court and Cause]

PRE-TRIAL ORDER

It appearing that the within cause was fully before Judge Hollzer during his lifetime; that counsel for defendant and plaintiff are both of the opinion that the Court may be fully advised of the facts in the case by the submission of the case upon the documentary evidence, the Stipulations of Fact, and the transcript of the testimony of witnesses in the previous trial, together with all the pleadings and briefs which are a part of the record of this cause; that counsel for defendant and plaintiff are both agreeable to such a submission of the case; and that the Court has viewed the property involved in company with respective counsel;

It Is Ordered that this cause be taken under submission on the merits by the Court on or after July 26, 1946, upon the same files, record, evidence, transcript and briefs as heretofore submitted to Judge Hollzer, subject to the taking of any additional evidence or proceedings which the Court may desire and indicate by further order.

Dated this 2nd day of October, 1946.

JACOB WEINBERGER

Judge

Approved as to form: Dempsey, Thayer, Deibert & Kumler, by W. P. Thayer, Attorneys for Plaintiff. James M. Carter, United States Attorney, E. H. Mitchell and George M. Bryant, Assistant U. S. Attorneys, Eugene Harpole, Special Attorney, Bureau of Internal Revenue, by George M. Bryant, Attorneys for Defendant.

A True Copy. Attest, etc., Mar. 24, 1948. Edmund L. Smith, Clerk U. S. District Court, Southern District of California; by Theodore Hocke, Deputy. [Seal]

[Endorsed]: Filed Oct. 5, 1946.

[Title of District Court and Cause]

## FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled cause came on regularly for trial on the 25th, 26th and 27th days of September, 1945 and on the 16th day of December, 1946, before the Court, sitting without a jury; plaintiff appearing by its attorneys, Dempsey, Thayer, Deibert & Kumler, and the defendant appearing by James M. Carter, United States Attorney for the Southern District of California, E. H. Mitchell and George M. Bryant, Assistant United States Attorneys for said District; and evidence both oral and documentary having been received and the Court having fully considered the same, hereby makes the following special Findings of Fact:

### FINDINGS OF FACT

#### I.

Plaintiff is, and at all times pertinent hereto was, a corporation organized and existing under and by virtue of the laws of the State of California, duly qualified to transact business in said State and having its principal place of business at Room 735 Roosevelt Building, Los Angeles, California, within the [61] Sixth Internal Revenue Collection District of the State of California.

#### II.

The taxes sought to be recovered in this proceeding were collected by Nat Rogan, Collector of Internal Revenue for the Sixth District of California on behalf of the United States of America. The said Nat Rogan is no longer in office.

## III.

Plaintiff filed its income tax return on or before the due date for its taxable year ending August 31, 1939 showing a net income of \$37,337.55, and paid therewith collector [JW] to the said ^ Nat Rogan the sum of \$6,279.36 as its income tax liability based upon the net income shown in said return.

## IV.

On July 7, 1942, the Commissioner of Internal Revenue asserted a deficiency in federal income taxes against plaintiff for its taxable year ending August 31, 1939 in the sum of \$3,389.55 together with interest thereon. That said deficiency was based upon a liability for surtaxes under Section 102 of the Revenue Act of 1938. Thereafter on about the 31st day of July, 1942, plaintiff paid said collector [JW] to ^ Nat Rogan on account of said deficiency the amount of \$3,942.46 which was applied as follows:

On the alleged deficiency for the year ended August 31, 1939, under Section 102 of the Revenue Act of 1938	\$3,389.55
Interest on said alleged deficiency	551.24
Overpayment for year ended August 31, 1939	1.67
	<hr/>
Total taxes and interest paid	\$3,942.46
	<hr/> <hr/>

## V.

The plaintiff duly filed its income tax return for its taxable year ending August 31, 1940 showing a net income of \$21,870.32 and paid with said return the sum of \$2,535.91 as its income tax liability for the said taxable year. Thereafter on July 7, 1942, the Commissioner of Internal Revenue asserted a deficiency in federal income taxes against plaintiff for the taxable [62] year ending August 31, 1940 as follows:

Income tax under Section 13, Internal Revenue Code	\$ 924.46
Surtax under Section 102, Internal Revenue Code	5,112.03
<hr/>	
Total deficiency asserted	\$6,036.49

The deficiency in taxes asserted for the fiscal year ended August 31, 1940 was based upon, first, the disallowance of depreciation deducted in plaintiff's return for said year in the amount of \$4,538.18 resulting in an increase in the income tax liability of plaintiff under Section 13 of the Internal Revenue Code in the amount of \$924.46, and second, the assertion of liability for surtaxes under Section 102 of the Internal Revenue Code in the amount of \$5,112.03 resulting in a total additional tax deficiency asserted against plaintiff for said taxable year in the amount of \$6,036.49.

## VI.

Thereafter and on or about July 31, 1942, plaintiff paid to Nat Rogan, Collector of Internal Revenue at Los An-



geles, on account of said asserted deficiency in taxes, the amount of \$6,658.99, which was applied as follows:

On the alleged deficiency for the year ended August 31, 1940, under Section 13, Internal Revenue Code	\$ 924.46
On the alleged deficiency for the year ended August 31, 1940, under Section 102, Internal Revenue Code	5,112.03
Interest on said alleged deficiencies	619.52
Overpayment for the year ended August 31, 1941	2.98
	<hr/>
Total taxes and interest paid	\$6,658.99
	<hr/> <hr/>

## VII.

On or about August 7, 1943, and within two years of the date of the payment of the federal income tax deficiency asserted by the Commissioner of Internal Revenue as aforesaid for the taxable years of plaintiff ending August 31, 1939 and August 31, 1940, plaintiff filed its claims for refund of the taxes and interest paid as aforesaid. Said claims set forth the grounds [63] for refund relied upon by plaintiff and set forth sufficient facts to apprise the defendant and Commissioner of Internal Revenue of the exact basis of the claims. On November 5, 1943, the Commissioner of Internal Revenue mailed by registered mail his notice of disallowance of said claims for refund insofar as the same were based upon deficiencies asserted under Section 13 and Section 102 of the Internal Revenue Code for the years in question except-

ing only that the Commissioner determined an over-assessment of \$41.98 for the taxable year ended August 31, 1939, and an overassessment in the sum of \$85.75 for the taxable year ended August 31, 1940. On June 28, 1944, the plaintiff filed this action.

### VIII.

That plaintiff during the course of this trial abandoned its claim with respect to income taxes under Section 13 of the Internal Revenue Code in the amount of \$924.46 together with the interest paid thereon.

### IX.

That plaintiff corporation was not formed for the purpose of preventing the imposition of surtaxes upon its shareholders.

### X.

That plaintiff corporation was availed of for the purpose of preventing the imposition of surtaxes upon its shareholders during each of its taxable years ending August 31, 1939 and August 31, 1940. In 1939, the corporation had a taxable net income of \$37,337.55 and distributed dividends amounting to only \$17,500., of which amount \$15,000. was used to purchase a ranch for the stockholders' son. In 1940, the taxable net income was determined by the Commissioner to be \$26,408.50, and in that year dividends of only \$2500. were distributed. Plaintiff's surplus account in 1933 was \$153,927.78. In 1940, this account was \$213,632.92. Plaintiff's security investments in 1940 at the end of its fiscal year had a book cost of \$157,093.29 and a fair market value of

\$114,125. As a result of the accumulations in the taxable years here involved, the plaintiff's two shareholders avoided surtaxes in their personal income tax of \$2,402.99 in 1939 and \$4,199.68 in 1940. [64]

## XI.

The properties of the school in 1946 were in good repair and have not been substantially altered but have been modernized since the taxable years in question. The properties are being used at the present time for substantially the same purposes as those during the taxable years in question with the exception that the boarding school activities formerly carried on by the lessee have been abandoned.

## XII.

During the two taxable years in question, plaintiff conducted no substantial activities other than the management of its investments and the receiving of rentals from the lessee of the school properties. The taxes upon the school properties were paid by the lessee under the terms of the lease. This lease also provided for certain consultations between plaintiff and the school operator.

From the foregoing facts the Court concludes:

## CONCLUSIONS OF LAW

### I.

That plaintiff was a holding company within the meaning of Section 102 of the Internal Revenue Code during each of its taxable years ending August 31, 1939 and August 31, 1940.



II.

The plaintiff in its taxable year ending August 31, 1939 was availed of for the purpose of preventing the imposition of the surtax upon the income of its shareholders through the medium of permitting its earnings and profits to accumulate instead of being divided or distributed.

III.

The plaintiff in its taxable year ending August 31, 1940 was availed of for the purpose of preventing the imposition of the surtax upon the income of its shareholders through the medium of permitting its earnings and profits to accumulate instead of being divided or distributed. [65]

IV.

The plaintiff has not proved that there was no purpose to avoid the imposition of surtax upon the income of its shareholders.

V.

The defendant is entitled to judgment that plaintiff take nothing and for its costs.

Dated: August 30, 1947.

JACOB WEINBERGER

Judge

Approved as to Form, as required by Rule 7(a). Dated: August 27, 1947. Dempsey, Thayer, Deibert & Kumler, by W. P. Thayer, Attorneys for Plaintiff.

[Endorsed]: Filed Aug. 30, 1947. [66]

In the District Court of the United States in and for the  
Southern District of California

Central Division

Civil No. 3727-W

MARLBOROUGH CORPORATION,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

### JUDGMENT

The above-entitled cause came on regularly for trial on the 25th, 26th and 27th days of September, 1945 and on the 16th day of December, 1946, before the Court, sitting without a jury; plaintiff appearing by its attorneys, Dempsey, Thayer, Deibert & Kumler, and the defendant appearing by James M. Carter, United States Attorney for the Southern District of California, E. H. Mitchell and George M. Bryant, Assistant United States Attorneys for said District; and evidence both oral and documentary having been received and the Court having fully considered the same and having made and duly entered its Findings of Fact and Conclusions of Law herein;

Now, Therefore, by reason of the law and the facts herein, It Is Ordered, Adjudged and Decreed that the defendant is entitled to judgment that plaintiff take nothing by its complaint and defendant is entitled to its costs in this behalf incurred which are hereby taxed in the sum of \$23.39.

Dated: this 30 day of August, 1947.

JACOB WEINBERGER

Judge [67]

Approved as to Form, as required by Rule 7(a). Dated: August 27, 1947. Dempsey, Thayer, Deibert & Kumler, by W. P. Thayer, Attorneys for Plaintiff.

Judgment entered Aug. 30, 1947. Docketed Aug. 30, 1947. C. O. Book 45, page 183. Edmund L. Smith, Clerk, by J. M. Horn, Deputy.

[Endorsed]: Filed Aug. 30, 1947. [68]

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[Title of District Court and Cause]

NOTICE OF APPEAL TO UNITED STATES  
CIRCUIT COURT OF APPEALS

Notice is hereby given that Marborough Corporation, plaintiff above named, hereby appeals to the United States Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on August 30, 1947.

THOMAS R. DEMPSEY  
WELLMAN P. THAYER  
ARTHUR H. DEIBERT  
WILLIAM L. KUMLER

Attorneys for Appellant  
523 West Sixth Street  
Los Angeles 14, California

[Endorsed]: Filed & mld. copy to Geo. M. Bryant, Atty. for Deft., Nov. 25, 1947. [69]

[Title of District Court and Cause]

MOTION FOR EXTENSION OF TIME FOR  
FILING RECORD ON APPEAL

Comes now the appellant in the above entitled cause and moves the Court for an order extending the time for filing the record on appeal and docketing the action in the United States Circuit Court of Appeals to February 3, 1948.

WILLIAM L. KUMLER  
Attorney for Appellant  
523 West Sixth Street  
Los Angeles 14, California

So ordered, this 29 day of December, 1947.

By JACOB WEINBERGER

Judge

[Endorsed]: Filed Dec. 29, 1947. [70]

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[Title of District Court and Cause]

STIPULATION FOR ORDER TO TRANSMIT  
ORIGINAL DOCUMENTS AS PART OF THE  
RECORD ON APPEAL

It Is Stipulated By and Between the parties, through their respective counsel, that the District Court may enter its order authorizing the transmission of the original papers constituting Stipulations Nos. 1, 2, 3 and 4 and the original exhibits filed in the above proceedings, to the Appellate Court as part of the record on appeal in lieu of copies thereof.

Dated: March 1, 1948.

\* \* \* \* \*

[Endorsed]: Filed Mar. 2, 1948. [77]

[Title of District Court and Cause]

ORDER FOR THE TRANSMISSION OF ORIGINAL  
PAPERS AND EXHIBITS AS PART OF THE  
RECORD ON APPEAL

Upon stipulation of the parties and for good cause  
shown,

It Is Ordered:

1. That in lieu of copies the Clerk shall send to the  
Appellate Court the original copies of Stipulations Nos.  
1, 2, 3, and 4 and the original exhibits, filed in the above  
entitled cause, as part of the record on appeal.

2. That such original stipulations and exhibits shall  
be placed in the custody of the Clerk of this Court for  
safekeeping and transportation to the Appellate Court.

Dated: March 2, 1948.

JACOB WEINBERGER

Judge

[Endorsed]: Filed Mar. 2, 1948. [78]

[Title of District Court and Cause]

## CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the District Court of the United States for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 86, inclusive, contain full, true and correct copies of Complaint for Recovery of Federal Income Taxes Illegally Assessed and Collected; Answer; Stipulation After Pre-Trial Conference; Findings of Fact and Conclusions of Law; Judgment; Notice of Appeal; Motion and Order Extending Time for Filing Record on Appeal; Stipulation for and Order Correcting Reporter's Transcript; Statements of Points on Which Appellant Intends to Rely; Stipulation for and Order for Transmittal of Original Documents; Appellant's Designation of Record on Appeal; Stipulation Designating Record on Appeal and Docket Entries which, together with copy of Narrative Statement of the Testimony; Original Stipulations Nos. 1 2, 3, and 4, copy of Reporter's Transcript of October 2, 1945; and Original Plaintiff's Exhibits 1 to 5, inclusive, and Defendant's Exhibits A to M, inclusive, transmitted herewith, constitute the record on appeal to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that my fees for preparing, comparing, correcting and certifying the foregoing record amount to \$20.90 which sum has been paid to me by appellant.

Witness my hand and the seal of said District Court this 9 day of March, A. D. 1948.

(Seal)

EDMUND L. SMITH

Clerk

By Theodore Hocke

Chief Deputy



[Title of District Court and Cause]

NARRATIVE STATEMENT OF THE TESTIMONY

The above cause was heard before The Honorable Harry A. Hollzer on September 25th, 26th and 27th, 1945, and before The Honorable Jacob Weinberger on December 16, 1946, after the death of Judge Hollzer while the matter was under submission to him.

Appearances at all three proceedings were:

For the Plaintiff: Dempsey, Thayer, Deibert & Kumler, by William L. Kumler, Esq., 1104 Pacific Mutual Bldg., Los Angeles, California.

For the Defendant: Charles H. Carr, United States Attorney, by George M. Bryant, Assistant United States Attorney; Eugene Harpole, Special Attorney, Bureau of Internal Revenue.

During such proceedings the testimony of the following witnesses was heard by the Court and taken by the reporter:

For the Plaintiff: Eugene Overton, Morgan Adams, John C. Austin, Thompson Webb, Hugh L. Mann, and Georgia Overton.

For the Defendant: C. G. Brown.

So much of the testimony as is material and necessary to the determination of the point upon which Appellant intends to rely on the appeal is hereinafter set out.

References are to the original Reporter's Transcript of Proceedings.

## EUGENE OVERTON,

a witness for the Plaintiff, being first duly sworn, testified as follows:

## Direct Examination

"During the years 1939 and 1940 I was director and president of the Plaintiff corporation. I was the officer primarily concerned with the financial problems of the business. I have occupied that position since 1924. (T. 4.)

"During the taxable years ended August 31, 1939 and August 31, 1940 the earnings of the business were accumulated for the purposes of the business of the corporation. The explanation is rather long. Some of the considerations entering into my determination to accumulate earnings were: (T. 6.)

"(a) The Marlborough School is owned by the Marlborough Corporation. Marlborough School was started 56 years ago by my mother-in-law, Mrs. Mary S. Caswell. (T. 6.) Mrs. Caswell was the sole owner of the stock from the incorporation of the company, in 1910, until her death in 1924. (T. 9.) After her death Mrs. Overton inherited the stock of the corporation, and thereafter Mrs. Overton and I divided everything we had as equally as possible between us by agreement. That is how I became a half-owner of the stock of the corporation. (T. 9.) First the school was located in Pasadena and shortly after was moved to Twenty-third Street, a little east of Hoover Street in Los Angeles. By 1916 the population of the city had so shifted westerly that she determined she would have to move the school to keep up with the population. She moved it to the present location on the corner of Third and Rossmore in Los Angeles.

(Narrative Testimony of Eugene Overton)

(T. 6.) In connection with that move the corporation got into serious financial difficulties. Mrs. Caswell had not accumulated money against such a move, and, without going into details, she came very nearly going broke. At the time of her death, in 1924, the corporation was quite heavily indebted. My recollection is that we finally paid off that indebtedness, excepting debts to Mrs. Overton, my son and myself in 1934. From that time on it was my purpose and the purpose of Mrs. Overton—having had the trouble and knowing the [2\*] trouble that had been gotten into and knowing even then that the population was shifting west very fast—to accumulate money against such a contingency. (T. 7.)

“(b) Another reason was that I thought—and when I say I thought, I discussed all these matters with Mrs. Overton but I think she left most of the decisions to me—I felt the school should have a very substantial backlog in case of fire, earthquake or contingencies of that kind. (T. 7.)

“(c) At that time and until 1942 the school was leased and I thought that if the corporation had to take over the management of the school on the expiration of the lease, either at its regular termination or before, it would need a considerable sum of money for renovations, improvements and things of that kind. (T. 8.)

“(d) The properties were of course depreciating. In 1939 I think the depreciation must have been close to \$170,000. (T. 8.)

“(e) I always figured in my mind that the corporation, particularly a business of this kind, which is a very pre-

\*Page number appearing at bottom of page of Narrative Statement of Testimony.

(Narrative Testimony of Eugene Overton)

carious business and a very hard business to raise money on from banking institutions, should have a backlog of roughly \$250,000 and for that reason as soon as possible I started to accumulate money. (T. 8.)

"Prior to the taxable years in question I summarized the business needs to which I have referred in a pencil memorandum. My best recollection, and it is only a guess, was that it was made along about 1936 or 1937. It was merely for my own information and I just stuck it in the minute book loose. The purpose was to satisfy myself as to whether or not my belief was correct that this corporation should have a backlog of around \$250,000. Then later, maybe a year or a year and a half later, I made a second memorandum which I had typed and this is it. I failed to put a date on it. (T. 10-11.) Then I made another memorandum in the minute book, dated November 7, 1939, which I signed and put in the minute book. It follows the index of the minutes. (T. 12.)"

(At this point in the testimony the undated memorandum was offered and received in evidence as Plaintiff's Exhibit No. 1, and the memorandum dated November 7, 1939 was offered and received in evidence as Plaintiff's Exhibit No. 2.)

Mr. Overton resumed.

Q. By Mr. Kumler: "Mr. Overton, referring to Plaintiff's Exhibit No. 1, [3] which is your undated memorandum, and your testimony relative to the reasons for accumulating funds in this corporation in the years 1939 and 1940, item No. 1 is in the amount of \$20,000, to cover a possible fire loss not compensated for by insurance, estimated at \$20,000. Will you please explain the business purpose involved in that provision?"

## (Narrative Testimony of Eugene Overton)

A. "Yes. I would first like to explain that memorandum a little more. That memorandum was a very informal one. In fact all three of these memoranda of mine were informal. They were not based on a careful study. They were based on estimates I made. Some of the matters, after discussion with Mrs. Overton, were estimates I made of possible or probable needs of the corporation. They were not based on accountant's or auditor's or Price, Waterhouse figures. So I don't want the impression gotten out that they were accurate in any sense of the word. They were figures I made more to see if I was justified in my own mind that the corporation ought to reserve or accumulate. To answer your question, we always kept the buildings quite heavily insured. (T. 13-14.) I knew from experience, as anyone does, that in case of fire loss the insurance never covers the loss. So I estimated \$20,000 was a conservative amount to put down as the difference between what would be collected, if there were a conflagration, and the amount that would be lost. There was a considerable fire risk. The coverage today is very little different, if any, from the coverage then. There were three policies totalling \$190,765. Those were all 90 per cent co-insurance policies. Then we carried what I called contingent liability for rebuilding. I had a good deal of trouble getting this type of insurance but it is to help cover the difference in cost of rebuilding the buildings, under present ordinances, which would have to be fireproof. The contingent liability insurance amounts to \$119,000 and is purely contingent insurance to cover the difference in cost nowadays and what it [was] would have been. The contingency insurance was in effect during the taxable years." (T. 14-15.)



(Narrative Testimony of Eugene Overton)

(On the following day the witness amplified the foregoing testimony as follows.)

"I would like to add to a statement I made yesterday when we were discussing the informal memorandum. I forgot another serious contingency in case of fire or earthquake. If during the school term the school should have a serious [4] fire loss, so it could not be operated, it would require a great deal of free capital to meet the obligations to return the tuition, pay the teachers who are under contract, and the help and all those things. There are those three considerations I always had in mind in wanting to accumulate a fund. (T. 147.)

\* \* \* \* \*

"Directing my remarks to the taxable years in question, the second item in Plaintiff's Exhibit No. 1, in the amount of \$15,000, is an item I got after discussion with Mrs. Overton. She has felt for years that the boarding department should be dispensed with. She was the authority on the school angles, while I claimed to be the authority on financial angles of the business. She, in discussing it, told me that if and when the corporation again took over actual operation of the school because of termination of the lease, one of the first things she would do would be to dispense with the boarding department. In doing so she would then endeavor to increase the day school and that would need considerable remodeling of the bedrooms and turning them into classrooms and things of that kind. It was actually done as soon as Mrs. Overton took over the principalship of the school in 1942. (T. 16-17.)

"The \$35,000 item shown in Plaintiff's Exhibit No. 1 was obtained after discussion with Mrs. Overton. The



## (Narrative Testimony of Eugene Overton)

gymnasium, showers, dressing rooms, locker spaces and those things were then badly in need of remodeling and modernizing; for instance, it should all be sealed. A school of that kind has to be kept in first-class condition. That is old-fashioned. It was built in 1916 and not at all according to modern requirements. That was going to cost a considerable sum of money. That was one item involved in the \$35,000. Maybe it was the only one; I don't know. It will cost a lot of money to do it and it has got to be done as soon as labor and materials can be gotten. (T. 20.)

"The estimate of \$50,000 for working capital in the event the lease is terminated and active conduct of the operation is resumed is just an estimate. I stated in the memorandum, 'So far as can be foreseen at the present time, these probable business requirements and contingencies are believed to be as follows.' I did not consider this a definite or accurate statement as to computation and I don't yet. We knew or presumed we would have to take over the operation of the [5] school. To operate the school during the summer months, pay the help, pay the staff that has to be kept which is considerable, and for food, operating expenses, lights, furniture and a certain amount of repairs that have to be made every summer would cost \$20,000 to \$25,000. Then there should always be a considerable reserve for unforeseen contingencies. So without being able to give the items, I felt at that time that a \$50,000 working capital was a conservative estimate. (T. 21-22.)

"The \$67,000 item in Plaintiff's Exhibit No. 1 covers two factors. The books showed a large depreciation which I felt ordinary good business judgment required should be

(Narrative Testimony of Eugene Overton)

covered as far as possible. I think I stated that in 1939 the depreciation on the books was \$170,000. Then, the possibility or probability of having again to move the school was a very serious consideration and still is, and that was taken into account in the figure, which, incidentally, I have since learned is rather inadequate. (T. 22.)

"I probably put down 'obsolescence' and 'depreciation' more or less thoughtlessly. I am not an accountant. What I think I meant by that was the difference in cost, if the school had to be moved. (T. 23.)"

The Court: "May I interrupt here to see if I understand this last answer? Do you have anywhere in that memorandum set down a rough estimate of what would be required to modernize the whole structure or combination of structures?"

The Witness: "Yes; in this way, I think, your Honor. We have already discussed that item of \$35,000, which I have down here as additions to buildings and new buildings that may be required, estimated at \$35,000; to provide for working capital if the present lease on the school should be terminated, \$50,000. This also not only was necessary, the \$35,000 for operating expenses and for renovation during the summer months, but necessary to provide money for renovating, painting, and all kinds of repairs and modernizing, wall papering, and all those things we knew would have to be done. Does that answer your question?"

The Court: "Is that the last item to which you are referring?"

The Witness: "The last item is the item of \$67,000 to provide for obsolescence and depreciation.

## (Narrative Testimony of Eugene Overton)

The Court: "That is what I say. It isn't clear to me what distinction in your estimates you drew between the items already described and the [6] other items that you included under this last estimate of some \$67,000.

The Witness: "As to the \$67,000 item, as I say, the corporation's books showed a large depreciation in the value of the buildings and in the furniture and fittings and so on. I was trying to set up a reserve, to equalize the depreciation shown on the books, entirely outside of the amount necessary for renovating, new constructions, and things of that kind. (T. 23-24.)

"The contingency insurance carried to cover the excess cost of rebuilding which would have been due to the difference in building codes and the requirements of the laws with respect to school buildings, would not have covered the excess cost. I had that definitely in mind in the considerations summarized in the memorandum. (T. 25.)

"In the event the buildings were 'replaced' the insurance wouldn't cover it at all. The \$67,000 item, which I termed 'obsolescence' and 'depreciation' undertook to take that factor into account. Incidentally it wasn't with the idea of it ever being analyzed in a proceeding of this kind. Otherwise, I would have been more careful with it. I (Eugene Overton) wanted it in the minute book in case anything happened to me and Mrs. Overton. We went to sea a great deal and might get drowned, and I wanted it there, so that our son, our only child, would be able to base his action on it in connection with the school business. So it had a double purpose. My estimate of \$67,000 was quite inadequate. (T. 26.)

"The indebtedness to Mark Overton, Georgia C. Overton and Eugene Overton of \$35,500 was the same as that

(Narrative Testimony of Eugene Overton)

shown in my sheets for 1939 and 1940 fiscal years. (T. 26.)

"Plaintiff's Exhibit No. 2 shows an item of \$75,000 for obsolescence and depreciation whereas plaintiff's Exhibit No. 1 shows \$67,000 merely because new building costs were increasing. I had a very rough estimate which I have since found was very wrong of what the difference in cost would be in case the school had to be rebuilt or moved and that is the reason for the difference. (T. 29.)

"The item of \$35,500 representing indebtedness to the Overtons is absent from the second memorandum because I presume I forgot to put it in. The indebtedness has never been paid. (T. 29.)

"Borrowing for school purposes is extremely difficult as I stated earlier. A school is not, in banking circles, a good risk and it was my experience, based on what I learned in the early days, when Mrs. Caswell was trying to borrow money that it is extremely difficult to borrow more than the bare value [7] of the land because it is a specialized type of building and because a school anyway is a great risk. If we had to borrow as much as possible I think a bank or loaning agency would be extremely hesitant to loan more than 50 to 60 per cent of the base value of the land the school was on. (T. 29-30.)

"The only experience I have had with school financing is in connection with Marlborough. I have never been connected, either as counsel or otherwise, with any other school. So anything in that connection would be hearsay on my part. The best way to illustrate will be to give the history of the borrowing of the school as a corporation. In 1916 or 1915, when Mrs. Caswell decided to move the school she had practically no reserve. She had



(Narrative Testimony of Eugene Overton)

her old school property. First she arranged for the purchase of the property where the school now is from G. Allen Hancock, who was then subdividing the whole area and thought the school would benefit his tract. He sold her the property at a give-away price. She paid \$14,000 for 200 feet on Third Street and 712 and a fraction feet on Rossmore. Mrs. Caswell had the plans for the school drawn by Mr. John C. Austin. The corporation then made a contract with a contractor to build what we call the main building and he agreed to take the old school property down on Third [Twenty-third] Street in at, my recollection is, about half the contract price. Then Mrs. Caswell had to provide the difference between that and the seventy some thousand dollars. In other words, as I recall she had to provide about \$35,000 or \$40,000 in cash to make up the difference. She tried to borrow that and frankly, she couldn't borrow it. This is part of my knowledge. I was part of it at the time. Finally I made arrangements with the Mortgage Guarantee Company to borrow, I think it was, about \$52,000 which was necessary for the difference in the building cost and for the expense of moving, laying out the grounds and new furniture and all incidentals. Mrs. Caswell found it impossible to borrow the money and finally, through my personal actions with the Mortgage Guarantee Company and with Mr. Morgan Adams who was, I believe, president of it then, I succeeded in making that loan and I had great difficulty. But it was not made with the Mortgage Guarantee Company but with the Bond Investment Company, a subsidiary of the Mortgage Guarantee Company. The Corporation borrowed \$52,500 and gave a first lien trust deed to secure three notes, one for \$40,000, one for \$2,500 and

(Narrative Testimony of Eugene Overton)

one for \$10,000. The Bond Investment Company wouldn't make the loan unless the \$10,000 note was otherwise secured and finally [8] G. Allen Hancock endorsed that \$10,000 note. Then the Corporation had to give a second mortgage to Mr. Hancock to secure him. Then Mr. Hancock loaned \$14,000 personally which he required me personally to guarantee. A third mortgage was given to me and I assigned it to him to secure the \$14,000 I had guaranteed. It was a pretty involved situation. The school was in dire financial straits and had it not been for the fact that we were able to make these loans in that way and the fact that Mr. Hancock was willing to accept my guarantee for \$14,000 and in those days \$14,000 looked like a lot of money to me, the school would have failed, definitely. (T. 32-35.)

The Court: "I would like to clear up one item which is not clear at least in my own mind. Did I understand you to say that the Bond Investment Company loaned \$40,000 on a first lien against the property?"

The Witness: "Yes. May I read this again to your Honor? This is a memorandum that I made recently from the books and records of the corporation. I made it myself. On May 27, 1916, the corporation borrowed \$52,500 from the Bond Investment Company and gave a first lien trust deed to secure three promissory notes, one for \$40,000, one for \$2,500 and one for \$10,000. Then the \$10,000 note was also guaranteed or endorsed by Mr. Hancock. Then, in addition to that, Mr. Hancock loaned \$14,000, which was found to be needed, which note was \$14,000 I endorsed.



(Narrative Testimony of Eugene Overton)

The Court: "Did the Bond Investment Company receive any other security or personal guarantee on the first lien so far as the \$40,000 was concerned?"

The Witness: "The \$40,000 was secured only by a lien on the property.

Q. By Mr. Kumler: "Mr. Overton, from what sources did the funds come to repay these loans?"

A. "From the earnings of the school.

Q. "Did you pay interest on the loans?"

A. "Oh, yes.

Q. "What effect did the payment of interest have on your earnings?"

A. "Of course, it reduced the earnings.

Q. "And then it reduced your ability to repay?"

A. "Certainly. [9]

Q. "During the years 1939 and 1940, was the corporation actually conducting the school business, that is, the academic part of it?"

A. "The corporation was not conducting the academic end of the school business. The school was under lease at that time to a Miss Blake.

Q. "Was it a written lease?"

A. "Yes; and the school, or the corporation, had the right to certain supervision under the terms of the lease.

Q. "Mr. Overton, I am showing you Exhibit A to Stipulation No. 3, which is a lease agreement between the Marlborough Corporation and Ada S. Blake. I will ask you if that is the lease that was in effect during the taxable years.

A. "The lease is dated September 1, 1935. That was in effect. There may have been some modifications, and I think very probably there were, by 1939.

(Narrative Testimony of Eugene Overton)

A. "I would have to look at my records to see, but this was the basic lease at that time.

Q. "Were the modifications in the terms of the lease or in the amount of the rental? Can you state to what the modifications were limited?

A. "I would not want to state that without looking at my records. Do you want to take the time?

Q. "Will you look on page 10 of the lease and tell the court whether the provision entitled 'VII. Policies, Salaries, General Expenses, Permanent Improvements—' well, just a minute. Will you excuse me a minute, your Honor, until I compare this with the original? Yes; that is it. 'VII. Policies, Salaries, General Expenses, Permanent Improvements.' I would like to have you examine that provision and tell the court if that provision was in effect during the taxable years, without modification.

A. "Yes; that provision is in effect at this time and had been in effect since the school was first leased to Miss Blake. That provision was in effect in all of the prior leases.

Mr. Kumler: "I would like to read a portion of that provision. 'It is understood that the lessee, during the term of this lease, shall have the entire control and management of the school in all its branches and departments without interference by the lessor; provided, however, that the lessee shall [10] not, without first obtaining the written consent of the lessor, make any fundamental or material change in any existing policy or plan upon which the school is now being conducted, or any general change in the present scale of salaries paid to teachers in the school, or any change in the present method of conducting the school which would involve a material increase or decrease

(Narrative Testimony of Eugene Overton)

in the cost of conducting it, or any addition, alteration, or permanent improvement to the premises, as distinguished from repairs and renewals incidental to upkeep.'

Q. "I will ask you, Mr. Overton, whether the powers and rights reserved in that paragraph to the lessor were exercised by the lessor during the time the lease was in effect.

A. "Yes; those powers were exercised at intervals over or during the entire tenancy of Miss Blake, under the provisions of the lease and those only.

Q. "Can you specify some of the occasions on which they were exercised?

A. "That is pretty hard to do. I personally—

Mr. Bryant: "Just one moment. I think I am going to object to this line of testimony. I presume it is sought to show the rights of operation retained by the corporation under the lease. That is a legal question which may be deduced from the terms of the lease which is included in Stipulation No. 3; and I feel that it is a question of law as to what their rights of operation were that were retained.

Mr. Kumler: "Would counsel like to stipulate it is presumed they exercised the rights they had under that section?

Mr. Bryant: "I think the witness has already testified to that; that they exercised whatever rights were retained under the lease.

Mr. Kumler: "Very well; we will pass on.

The Court: "This seems to be an appropriate hour for the noon recess." (T. 35-39.)

(Narrative Testimony of Eugene Overton)

(Mr. Overton's testimony, having been interrupted to convenience other witnesses, was resumed.)

"I can't say that, in 1939, we had definite plans with respect to operation of the school after the expiration of the lease in 1942. We didn't know whether we were going to renew the lease, let it terminate, or whether [11] Miss Blake wanted to renew it, but at that time there was a little question of whether or not we might not terminate the lease because of defaults. But we didn't. (T. 144.)

"When the lease did expire, we did not renew it. (T. 145.)

"Very definitely, the possibility of resuming active conduct of the school activity, was a consideration in our minds in 1939 as well as 1940." (T. 147.)

(At this point Mr. Overton added to his testimony of the previous day with respect to the provision in his informal memorandum relating to fire and earthquake contingencies. This correction has been noted, ante, at pages 4-5, of this Narrative Statement. It is not repeated here.)

"The business factors involved in our provision for the possibility of moving the school was, mainly, the westward trend of population that was taking place in the city before and during 1939 and 1940, long before. It is exactly the same factor that Mrs. Caswell ran up against and had to take into consideration when she moved to the present location. An analysis of the school attendance will show that during all those years and right up to the present time, the westward trend has been very marked; I mean the westward trend as to residences of pupils of the school.

(Narrative Testimony of Eugene Overton)

The percentage east and west of Rossmore has changed very materially towards the west. And we have always, for many years considered the very serious probability that the school would have to be abandoned where it now is and moved farther west.

“Page 3 of Stipulation No. 2, a tabulation of the shift of population as indicated by the location of residences of the day school students, from 1923 to 1945 was prepared under my direction (T. 148) and most of it by me. I was aware of the existence of the trend in the taxable years. I had not tabulated it as I have recently done. It is a matter that Mrs. Overton and I were watching all the time and discussing from time to time. We knew generally the trend without having tabulated it. We didn’t know in 1939 and 1940 when such a move would become necessary and don’t now.

“If the school is too far away from the residences of the students as it was when it was down on 23rd Street, and when Mrs. Caswell moved it in [12] 1916, the attendance drops off very materially, and eventually it would drop off to such an extent that the school could not be operated profitably and break even. (T. 149.)

“Consideration of the possibility of moving also involved the question of more room. The school is crowded for room. It hasn’t enough grounds around it and the restrictions won’t permit us to buy additional property for school purposes. I am not an expert on the school needs other than financial. I think Mrs. Overton is better qualified than I as to the needs for facilities, but I know the school needs, badly, more athletic fields or room.

Q. “Mr. Overton, I show you a schedule of depreciable assets and accumulated depreciation, appearing on page 2



(Narrative Testimony of Eugene Overton)

of Stipulation No. 2, assets owned by the corporation, and I would like to have you tell the court, if you will, which of those assets described in that schedule may be saved and moved to a new location if the school was moved.

A. "I would like to take a moment to look this over. The first one listed is frame school buildings. Those, of course, could not be moved. The second one is auditorium. That could not be moved. The third one is auditorium fixtures. I don't know what is meant by that. If it means fixtures such as electric appliances, some of those might be used; I don't know. I don't presume that means desks and furniture and things of that kind which could be moved.

Q. "I assume it means lighter fixtures, those things affixed to the building.

A. "Yes. Plant and machinery I would say couldn't be moved. Tennis courts obviously could not be moved. The sprinkler system could not be moved. The auto could be moved, if it would run. Linens, silver and dishes, yes, those could be moved. Here again is furniture and fixtures and there is an asterisk there. I would say that the furniture could be moved and as to the fixtures it would be doubtful. Some might be. The rugs, yes.

Q. "In view of the fact, Mr. Overton, that the schedule shows the rugs to be completely depreciated, would it be feasible, as a practical matter, to move the rugs? (T. 150-151.) [13]

A. "Well, yes; I think it would. There again, Mrs. Overton can tell you better than I know how good those rugs are. But, with due respect to the bookkeepers, because a thing is completely depreciated doesn't always mean it is not usable.



(Narrative Testimony of Eugene Overton)

Q. "In 1939 and 1940, Mr. Overton, did you have in mind the amount of money which would be necessary to buy land and erect new buildings at a new location if the school were moved?

A. "No; I can't say that we had in mind any definite sum any more than we had in mind any definite location. That was something that had to wait until the time to move and then pick the location and pick the land. So I couldn't say that we had anything definite as to figures or location in mind.

The Court: "May I interrupt to ask the reporter to read the question?"

(Question read by reporter.)

The Witness: "I knew, Mr. Kunler, that it would take a large amount of money. There was no way of figuring, as I say, definitely the amount until the time arrived to make the move, but, as I have stated several times before, the accumulation of funds to cover what I knew was the minimum that would be required was what I had in mind.

The Court: "Let me interrupt here to see if I understand the last answer. According to the reports, certain reserves have been accumulated. And did you give some thought as to whether or not these reserves were or were not in excess of those which, from general thinking, you believed that you would have to call upon?

The Witness: "Yes; I gave a lot of thought to that. Perhaps I had better explain that in this way to your Honor. As I believe I said yesterday, I had it in mind always that the school should have a cash or liquid security reserve of \$250,000. That was to cover or to provide as far as possible against the various contingencies

(Narrative Testimony of Eugene Overton)

that I mentioned. I knew, without having set down actual figures, that the school, if it had to move, would need more than \$250,000 for the purchase of land, buildings, new buildings, and so forth. It would have been silly for me to establish, for instance, or try to say that I was going to establish, a \$350,000 or a \$450,000 reserve, which is what I (T. 151-153) [14] think now and did then was the least that would be needed, because we couldn't do it. The profits over the years wouldn't justify it. There is no use reaching for a star when you can't reach it. So I took what I thought was a conservative stand in saying 'Well, let's accumulate \$250,000.' That was something that was in sight; that I saw that could probably be done within a reasonable time. But, as a matter of fact, it has not been reached yet. Does that answer your question?

The Court: "Yes.

"At the time Mrs. Overton and I considered the amount of dividends to be distributed for the years ended August 31, 1939 and 1940, and the amount to be retained, the matter of the tax effect on dividends paid was never discussed or raised. In handling the school funds I don't think I ever paid any attention to the tax angle. I won't say I didn't have it in mind. In the practice of law (T. 153) you have tax matters in mind all the time. But I did not let it influence my conclusions in any way; I made no computations and haven't to this day on the tax angle.

"The plaintiff has never loaned funds to its stockholders. Just the reverse. Mrs. Overton and I have loaned, I think, to pay off indebtedness, each \$20,000 or a total of \$40,000 to the school, which loans are still partly unpaid.

(Narrative Testimony of Eugene Overton)

The corporation has been indebted to Mrs. Overton and me since 1934, I think. I would have to look at the records.

Q. "I think the Stipulation shows that it was October 26, 1925.

A. "1925 that we loaned \$40,000?

Q. "The sum of \$40,000 to pay off the loan to the Mortgage Guarantee Company. Has that loan to the corporation been unpaid since that time?

A. "That loan of Mrs. Overton and mine, yes. Well, no; it has been partly paid or partly liquidated in a certain manner.

Q. "Do you recall what the balance is today?

A. "I think the amount due me is about \$5,500.

Q. "I mean the total balance owing to you.

A. "Yes; the total amount owing to both of us now, I think is \$20,000. I am not sure of that figure but I think so. (T. 153-155.) [15]

Q. "Mr. Overton, have the stockholders of this corporation ever transferred personal assets, such as residences, apartments, yachts, automobiles, or other similar property, to the corporation, which thereafter stood the expense of upkeep of the same?

A. "What is the question?"

(Question read by the reporter.)

Q. "With respect to which the corporation paid the cost of upkeep but the stockholders got the use?

A. "No, no; never.

Q. "Mr. Overton, have any profit-yielding properties, such as bonds, securities or oil properties, been transferred to this plaintiff corporation for the purpose of escaping personal surtaxes?

A. "Never.

(Narrative Testimony of Eugene Overton)

Q. "Mr. Overton, from 1910 to 1940 inclusive, a period of some 30 years, the stipulation does show that the earnings accumulated amounted to \$213,000, or an average over a year of \$7100. Did you, in 1939 and 1940, have the time element involved in accumulating those earnings over that period when you considered the amount that you would need in business?

A. "I don't understand your question as to the time element.

Q. "Let's put it this way. The stipulated facts show that the average rate of your ability to accumulate earnings from the corporation after the payment of taxes and dividends is \$7100 a year. When you were looking forward to these figures to which you have testified, did you have in mind the time element involved in accumulating the funds necessary?

A. "I had in mind, as I just stated to the court, that it was going to take a long time even to accumulate \$250,000 and it hasn't arrived yet.

Mr. Kumler: "That is all." (T. 155-156.)

Cross-Examination—Eugene Overton

"I can't answer whether, in 1937, 1938, 1939 or 1940, I discussed with accountants or other attorneys the surplus on hand. I assume that Price, Waterhouse, in making their audit discussed such matters and brought up some points. (T. 156.) I don't think I could specify any definite [16] conversations. I seem to have a recollection that those things were discussed to some extent.

"I had no assistance in preparing the memoranda, [plaintiff's] Exhibits 1 and 2. As I said yesterday, I sat down with a pencil and just made them up in my own



(Narrative Testimony of Eugene Overton)

mind, informally, and purely for my own satisfaction and incidentally with no idea that they would ever be for publication. Most of the figures I got out of my head. Some, on the additions to buildings and those things I got from Mrs. Overton. I am referring to items 2 and 3 in Exhibit 2, the remodeling of buildings in the event it is decided to eliminate the boarding department and for other contingencies. Yes I know I got from Mrs. Overton the additions to buildings and new buildings that may be required, that is item 3, of \$35,000. I know I got part and I must have gotten all of it from Mrs. Overton because I was not keeping in touch with the school's (T. 157) physical or academic needs.

"I think none of the discussions were recorded in the minutes. Our directors meetings were very informal. For a long time Mrs. Overton was not even a director. She was not a director during the taxable years in question. She resigned in May, 1938. At that time she was spending a lot of time at her ranch in the Mojave Desert and on one or two occasions when I needed her to hold a meeting I couldn't get her. So I suggested that she resign and I would put my secretary in her place.

"However, I was discussing my actions at all times with her. I never took any action (T. 158) that Mrs. Overton, I think, didn't know about."

(At this point defendant offered and there was received in evidence defendant's Exhibit C.)

"Mrs. Overton was again elected a director on June 29, 1942. That was after the taxable years in question."

(At this point defendant offered and there were received in evidence defendant's Exhibits "D," "E," "F," "G," "H," "I," "J," "K," "L" and "M.") (T. 159-162.)



(Narrative Testimony of Eugene Overton)

(Thereafter the cross-examination of Eugene Overton was resumed.)

"I would like permission to correct the testimony as to two or (T. 163) [17] three items."

(The Court granted permission.)

The Witness: "I stated yesterday that we were discussing the loans made by the Bond Investment Company to the Marlborough Corporation and that they were entirely paid out of earnings. That was incorrect. Those were paid, to the extent of \$40,000, out of the loans I testified to this morning that were made by Mrs. Overton and me to the corporation. We each loaned \$20,000 to the corporation and that money was used to pay the Mortgage Guarantee Company or the Bond Investment Company loans. I think that is an accurate statement. You asked me this morning about several discussions with Price, Waterhouse relative to accumulations and I stated I didn't remember any. As I was going out, Mr. Benson, who was with Price, Waterhouse at that time, reminded me that there had been some discussion or at least that they had mentioned to me the accumulations, in about 1939, I think it was, or 1940, and merely called my attention to that, and that I had stated I thought they were justified, or words to that effect. That is all he remembered and that is all I remember.

Q. "Is Mr. Benson in the courtroom now?"

A. "He is not now. He was this morning. Your Honor asked me this morning as to whether any loans had been made to the stockholders and I had forgotten for the moment. I ran across this the other day in going over the minutes to refresh my memory—

(Narrative Testimony of Eugene Overton)

Q. "Was that the temporary loan, Mr. Overton, made pending the payment of dividends?

A. "Yes; in 1932, a loan of \$1,000 to Mrs. Overton. I haven't and Mrs. Overton hasn't any recollection as to why that loan was made or anything. It was a loan of four or five days. As far as I recall, that is the only loan that was ever made.

Q. "In reference to the loans, Mr. Overton, that you have just referred to, who loaned that money to the corporation?

A. "You are speaking of the loans of \$20,000 each?

Q. "Approximately \$20,000 each.

A. "Mrs. Overton loaned \$20,000 out of her separate estate and I (T. 163-164) [18] loaned the same amount.

Q. "Did Mark Overton loan any of the money?

A. "No.

Q. "I notice that in your notes payable, of which I have a record only, beginning with 1931, you have a note payable to Mark Overton in the sum of \$14,986, from 1931 to 1933. Then, from 1934 through 1940, that loan was \$15,000.

A. "That loan is still \$15,000, Mr. Bryant, and still continues.

Q. "What did that arise from?

A. "That arose in this way. My mother-in-law, when she made her will, wanted to leave him a fairly considerable sum of money in her will. Mrs. Overton and I both objected as far as we had the right to object and asked her not to leave him money in her will and suggested to her, in the first place, that we hoped that she would not leave him out but he was a pretty young kid then and I didn't want him to think, when he was 21, he was coming

## (Narrative Testimony of Eugene Overton)

into a considerable sum of money, and asked her to leave it in a note or letter to Mrs. Overton and, when we thought it was proper for him to have it, we would pay it to him out of her funds. And that is what she did; she left a note asking that that be done. And we didn't let him know even that that money was coming to him until he decided he wanted to get married and we thought then it was time we paid it. So we paid him \$5,000 in cash out of the school funds and he asked for the balance in a note because he thought it was a good investment to keep it that way, and it has continued that way ever since. Then shortly after that, Price, Waterhouse took exception to the way I had done it, paying it out of school funds, saying that the Corporation couldn't give away money. Of course, technically, they are correct. It was worrying them and I didn't care, even though there were no stockholders or creditors to take exception to it, so I think I suggested that Mrs. Overton and I each be allowed a credit on the \$20,000 notes that the corporation owed us, a credit of \$10,000 each, to take care of the money that was paid to our son. So actually the money came out of Mrs. Overton and me and not out of the corporation.

Q. "When was that done? (T. 164-166.) [19]

A. "I can't tell you that.

Q. "Approximately?

A. "I can't tell you that. It is all shown, I think, in the minutes. I would have to look through them. It was done quite a few years ago.

Q. "Prior to 1931?

A. "When was the first loan made to him?

Q. "The only figure I have is it commences in 1931 and is carried through from that time.

(Narrative Testimony of Eugene Overton)

A. "Well, it was made, that shift, taking it out of Mrs. Overton and me instead of out of the corporation. That was made very shortly after the first payment to him and loan to him was made.

Q. "You loaned money to him?

A. "No; we gave him \$5,000 and then we gave him a note for \$15,000. It wasn't actually a loan.

Q. "Where did that money come from?

A. "It was merely carrying out the wishes of Mrs. Caswell which she left by letter. And, incidentally, I have that letter some place. What was that last question?"

(Question read by reporter.)

A. "Which money?

Q. "The \$5,000.

A. "The \$5,000 first came out of the corporation but shortly afterwards it came out of Mrs. Overton and me by reason of changing our notes, reducing the notes to us by \$10,000 each.

Q. "That is to say, then, you gave him \$5,000 plus notes for \$15,000?

A. "That is correct.

Q. "Of the corporation?

A. "Yes.

Q. "And you paid back to the corporation or took credit?

A. "No; I gave the corporation credit for \$20,000.

Q. "For \$20,000?

A. "Yes. Here is that letter, Mr. Bryant. (T. 166-167.) [20]

Q. "I am not particularly interested in the letter. The balance upon the notes is still \$21,500, the total balance?

A. "I think that is what the record shows.

(Narrative Testimony of Eugene Overton)

Q. "\$6,500 and \$15,000?"

A. "That is about it; yes.

Q. "And those balances were the same in both of the taxable years?"

A. "Yes. This is even carried on during the years.

Q. "How much interest has been paid upon those notes?"

A. "I think they are 7 per cent notes.

Q. "And you thereafter received, each year, upon \$6500, 7 per cent interest?"

A. "That is right, if it is 7 per cent; I am pretty sure it is; whatever the interest is.

Q. "And Georgia Overton, upon \$14,000, receives 7 per cent?"

A. "That is right.

Q. "And Mark Overton receives the same amount?"

A. "On \$15,000.

Q. "You have been able, at any time since at least 1925, to pay off those notes, have you not?"

A. "Yes.

Q. "At will?"

A. "Yes. Well, wait. You say since 1925? I don't remember the condition of the corporation's accounts back in 1925. I am not so sure but the corporation could have paid them off at any time in later years.

Q. "Well, say on August 31, 1931, it could have paid them off, could it not?"

A. "Well the corporation didn't get out of debt until 1934. It owed a considerable sum of money to the Spaulding Company on a loan that was made to build the auditorium building.



(Narrative Testimony of Eugene Overton)

Q. "Is that the mortgage, payable for the auditorium, due January 31, 1931?

A. "I presume it is. (T. 168-169.) [21]

Q. "And you retired that \$10,000 in 1932 and \$30,000 in 1933?

A. "I don't remember but I remember that the corporation was out of debt in 1934 excepting the indebtedness to Mrs. Overton and me and Mark.

Q. "That is the only indebtedness now due?

A. "That is all.

Q. "What is the maturity date of those notes?

A. "Do you mean to Mrs. Overton, my son and myself?

Q. "That is right.

A. "I can't tell you that. I renew them from time to time. I don't remember the maturity dates of them.

Q. "They have merely been renewed and you are just letting them stay there for the purpose of earning interest?

A. "No. As a matter of fact, I don't want interest. I am letting them stay there for the purpose of keeping a good, big balance in the bank account in the Marlborough Corporation. That is as to Mrs. Overton and me but, as to my son, he wants it that way. He wants it for the purpose of earning interest.

Q. "Are you familiar with the dividends paid by the corporation?

A. "I think so, in general.

Q. "What is your invested capital? Is it \$50,000, your capital stock?

A. "Authorized capital?

(Narrative Testimony of Eugene Overton)

Q. "Yes.

A. "\$50,000, I think. I think that was the authorized capital when I organized and incorporated the company in 1910. Yes; I am pretty sure it was \$50,000.

Q. "And it has remained the same, without change, since the time the corporation was organized?

A. "Yes.

Q. "In 1937, if I told you that the dividends paid were \$2,500, would you say that was correct?

A. "In 1937? (T. 169-170.) [22]

Q. "Yes; the fiscal year ending in 1937.

A. "I think so. We established a dividend policy of \$1.25 a share, I think, quarterly, and I don't remember when that began but I think it was in effect in 1937.

Q. "That amounted, approximately, to 5 per cent per year, did it not, on invested capital?

A. "I never figured it that way.

Q. "You merely wanted a yield of \$1.25 per year per share?

A. "That is all.

Q. "In 1938, for the fiscal year ending that year, is it not true that there was an extra dividend declared in the sum of \$3,000? What was the purpose of that extra dividend?

A. "I haven't any recollection at the moment. What date was that, Mr. Bryant?

Q. "For the fiscal year ending August 31, 1938.

A. "Do you know in what minutes that appears?

Q. "No; I don't. I have it from an analysis of your surplus.

A. "I guess you are more familiar with these books than I am.

(Narrative Testimony of Eugene Overton)

Q. "I have never seen the minute book.

A. "I know it has been quite a few times. This is off the record. There was a dividend, in May, 1938, of \$6.00 per share. I remember what that was for. That would appear in the minutes of 1939 probably.

Q. "It would be for the fiscal year ending August 31, 1938, the particular dividend in question?

A. "I don't seem to find any record of that.

Q. "I think it was prior to May, 1938.

A. "Prior to May, 1938?

Q. "I imagine it would be.

A. "I don't find anything and I am looking back to 1936 now.

Q. "You have no minute therefor in your books, authorizing the declaration of any dividends in the fiscal year ending August 31, 1938?

A. "Excepting that regular dividend of \$1.25 per share, which I see (T. 170-172) [23] was first authorized in January, by the minutes of January 8, 1936. 'Resolved that quarterly dividends on the stock of this corporation be and are hereby declared in the amount of \$1.25 per share per quarter, payable thereafter on the first days of April, July, October and January, to the stockholders of record five days prior to the date each dividend payment is payable.'

Q. "How many shares of stock are authorized by the Corporation Commissioner?

A. "There wasn't a corporation commissioner in those days, Mr. Bryant, but 500 shares were authorized. Wait a minute. Here is a dividend of \$6.00 per share, on the 13th of May, 1938. That would be \$3,000.

(Narrative Testimony of Eugene Overton)

Q. "That is \$6.00 per share?

A. "That is right.

Q. "And do you remember what that money was used for?

A. "No; I do not.

Q. "Directing your attention to the fiscal year ending August 31, 1939, and particularly to the month of January, 1939, was there an extra dividend declared in that year in the amount of \$15,000?

A. "There was \$30 per share.

Q. "And for what purpose was that dividend?

A. "That was to carry out the intent and desire of my mother-in-law as to my son, as I explained a few minutes ago. That money that she was to have given him, or wanted to give to him, as I explained, came finally out of Mrs. Overton and me. You might say it was sentimental but my son wanted a ranch and had an opportunity to buy one, and Mrs. Overton and I felt that, to carry out that intent and wish, the only fair thing was to do it. The price of the ranch was \$15,000—that is, the right thing to do to carry out her mother's wishes. So, to get around any second complaint from Price, Waterhouse, I declared a dividend or had a dividend declared, by which Mrs. Overton got \$7500 and I got \$7500, and we used that to pay for the ranch.

Q. "And that made a gift of the ranch to your son?

A. "That is right; later. We first put it in trust and then later made a gift of it to him. (T. 172-173.) [24]

Q. "When was the ranch given to your son?

A. "The operation of it was turned over to him immediately but the actual title to it was given to him quite a bit later.

(Narrative Testimony of Eugene Overton)

Q. "Do you remember when?

A. "No; I can't tell you when but I think we gave him a quarter interest—no; I can't remember the dates. I will tell you what we did, however. We turned over to him an undivided interest. I think it was a quarter one year and a quarter the next year and I think the remaining half the next year. He sold the ranch then. And the reason for that was to avoid the gift tax on Mrs. Overton and me.

Q. "By reason of the fact that the amount would be over the exemption?

A. "The value would be under the exemption.

Q. "And you consulted regarding the gift tax?

A. "No; I didn't need to consult about that. I don't know much about taxes but I do know that.

Q. "I don't think the record shows you have been an attorney in Los Angeles for quite some number of years, have you not?

A. "Since 1902.

Q. "And specializing in corporation matters?

A. "No; in general practice.

Q. "You have done considerable corporate practice, have you not?

A. "Quite a good deal.

Q. "And, as part of that, you necessarily have been presented with numerous tax problems?

A. "Yes; I have been presented with them but only the very simplest ones have I tried to advise on.

Q. "You have consulted with other attorneys or tax specialists on anything complicated?

A. "Yes.



(Narrative Testimony of Eugene Overton)

Q. "And you have done that throughout your practice, have you?"

A. "That is correct.

Q. "And also in the management of your business of the Marlborough (T. 174-175) [25] Corporation?"

A. "No; I have never had any advice as to those matters that I recall. I never paid much attention to the tax angle on the Marlborough Corporation. Price, Waterhouse made out the return always and at times I discussed matters with them. Usually I took what they said, however, and what they wrote out. Once we thought we had been overcharged, that is, the Marlborough Corporation, and I employed Mr. Kumler's firm in that case to appeal to the Board of Tax Appeals and the decision was our way in that. It was about \$1,500 as I recall. I think that is the only time I consulted outside counsel on tax matters for the Corporation.

Q. "However, you were hiring at all times during the taxable years in question and immediately preceding that time the firm of Price, Waterhouse, certified public accountants?"

A. "We started with Price, Waterhouse, as I recall, not for tax purposes at all but at the time the lease was entered into with Miss Blake. The lease provided that the books should be audited by Price, Waterhouse, or some other reputable firm, twice a year and that, I think, was the inception of it.

Q. "That was in 1925?"

A. "I think it was; yes.

Q. "Did Price, Waterhouse from that date thereafter also serve as accountants for the corporation as well as

(Narrative Testimony of Eugene Overton)

for the school, differentiating between the corporation and the operating business?

A. "Here is the way that was handled by Price, Waterhouse, or the way I asked them to handle it and the way it was provided in the lease, that the school was to be handled, so far as the accounting went, as a separate department of the corporation. In other words, the reason for that was this, that the rental under the lease was a fixed amount and a percentage of the profits of the school. Therefore, it was necessary that the accounts or that the audits should be in two divisions, one, the school operation, so as to know what the school profits were, or losses, and the other the amount of the corporation itself. Does that make it clear to you? I think it is all set out in the lease, if you have read it. (T. 176-177.) [26]

Q. "Yes; I have.

A. "Does that make it clear to your Honor?

The Court: "I would say I don't think it fully answers the question. Will you read the question, Mr. Reporter?

(Question read by the reporter.)

A. "They did serve not as accountants but as auditors for both the school and the corporation.

Mr. Bryant: "Is that sufficient?

The Court: "Yes.

Q. By Mr. Bryant: "Directing your attention to the claim for refund filed in this matter, are you familiar with that document?

A. "No; I can't say I am. That was prepared by Mr. Kumler and I remember reading it over and signing it but I don't think I have seen it since.

(Narrative Testimony of Eugene Overton)

Q. "Did you prepare or furnish to Mr. Kumler the figures for the minimum working capital requirements as of August 31, 1939, and August 31, 1940, as set forth therein?

A. "I don't remember, Mr. Bryant.

Mr. Kumler: "You had better show it to the witness.

Mr. Bryant: "I will.

Q. "Do you wish to see this photostatic copy, which is my copy?

A. "What is your question directed to?

Q. "To this part.

A. "Your question is did I furnish the items shown here?

Q. "Yes.

A. "Total, \$22,300?

Q. "That is right.

A. "No; I don't think I did.

Q. "Do you know who furnished those?

A. "I presume it was furnished by Mrs. Marsden, who was the financial vice-principal of the school. I presume she did.

Q. "You signed the claim for refund?

A. "I think I did; yes. (T. 177-178.) [27]

Mr. Bryant: "May I have Exhibits E and F, which are the two claims for refund filed by the corporation?

Q. "I show you the front page of Exhibit E and ask you if that is your signature or a photostatic copy of your signature appearing thereon.

A. "Yes; I think so.

Q. "And also upon the document Exhibit F?

A. "I think so.

(Narrative Testimony of Eugene Overton)

Q. "The 'Marlborough Corporation, by Eugene Overton, President'?"

A. "I think so.

Q. "Those figures were prepared as a part of this claim for refund which you signed and you did see it and examine it?"

A. "I remember that I read and saw that claim for refund that was prepared, I believe, by Mr. Kumler in his office.

Q. "Leaving with you Exhibit E and directing your attention to page 12 thereof, the minimum working capital requirements as at August 31, 1939, and August 31, 1940, which you duplicated upon the same page in Exhibit F, I will ask you to examine those figures.

A. "Yes.

Q. "Did those working capital requirements, amounting to \$22,300, set forth on that page, represent your best judgment as of the time the claim was verified, as to the operating and working capital?"

A. "Yes and no. It is headed 'Minimum Working Capital Requirements' and these items cover what I assume to be the estimated expenses of running the school during the summer months.

Mr. Kumler: "I think, if the court please, I will object to that question unless it also contains the statement on the preceding page that this is an estimate. I don't think the question completely states the fact unless it includes that statement.

The Court: "Perhaps the matter can be covered by redirect examination. The question in its present form doesn't seem to be open criticism.

(Narrative Testimony of Eugene Overton)

A. "This covers items that are pretty much the same every year, I think, for instance, advertising catalog, accounting, stationery, public relations man (T. 178-180), [28] annual salary, repairs and maintenance, and various items of that kind that are recurring each year. What was that question again, Mr. Reporter?

(Question read by reporter.)

A. "I will say yes insofar as the regular recurring items of expense every year but not insofar as any extraordinary or unforeseen expenses that might come up.

Q. By Mr. Bryant: "During the years 1939 and 1940, did you have any such expenses?

A. "We were not paying the school expenses at that time. That was being paid by Miss Blake and I don't know.

Q. "You had no such expenses, then, until the termination of the lease with Miss Blake on August 31, 1942?

A. "Yes; excepting that the lease was terminated. Your statement is correct, I think, excepting that the lease was terminated actually on June 12th or 13th, by mutual agreement, 1942.

Q. "Did you, in 1939, anticipate—

The Court: "Wait. Let me hear that answer again.

A. "The lease by its terms was terminable or to expire August 31, 1942, but, by mutual arrangement with Miss Blake, it was agreed that the actual termination should take place either June 12th or 15th, 1942, the reason for it being so that we could take over and make the necessary repairs, renovations, and all of those things, during the summer months.



(Narrative Testimony of Eugene Overton)

Q. By Mr. Bryant: "In 1939, did you anticipate any change in the terms of the lease in respect to the termination date thereof?

A. "I had a great deal of discussion and correspondence with Miss Blake for some years before the lease was actually terminated. Now I would have to go back and review my records to answer that question with any accuracy. I have a lot of that stuff here, if you want me to go over it.

Q. "Do you have that here with you?

A. "I have a practically complete file on the lease and its modification and so on.

Mr. Bryant: "I think the answer to that question is sufficiently (T. 180-181) [29] important to the government's case that the witness should be allowed to refresh his recollection from his records.

The Court: "Very well; you may look at your file.

A. "I am sorry, but that will take some little time.

The Court: "I think we will take a recess and I will ask counsel to advise the court when Mr. Overton has completed his examination.

Mr. Bryant: "We will be glad to do that.

(Short recess.)

A. "May I have that last question again that Mr. Bryant asked me?

(Question read by reporter.)

A. "I will try to answer that more in this way, Mr. Bryant—

Q. "Will you, first, please, Mr. Overton, answer it yes or no if you can? If you can't, so state and then explain your answer.

A. "No; I don't think I can answer it yes or no for this reason, that the lease by its terms was to terminate

(Narrative Testimony of Eugene Overton)

August 31, 1942. Now, it would have been extremely awkward for both the lessee and the lessor to have had it terminated at that time for the reason that the school term ends in June, about the middle of June. From that time on is the time that the renovations and all the summer expenses and repairs and so forth are made and new teachers are employed and enrollments of pupils for the next year come in. And that is not an undertaking that the lessee would want, or Miss Blake would have wanted, nor would we have wanted her to do it. In other words, the logical time to terminate the lease, which I didn't realize when I drew the lease years before, was the end of the school term and not the end of the fiscal year. Therefore, we anticipated because, had Miss Blake gone on to the end of August, she would have paid all of those summer expenses but, by terminating in June, as we did, the corporation had to pay them and the corporation made, or Mrs. Overton in this case, made all repairs, employed the new teachers and all the things getting ready for next year and enrolled the new students. We anticipated and hoped at that time that, if and when the lease was terminated, it would be terminated as of the end of the school term.

Q. "You considered that? (T. 181-183.) [30]

A. "Oh, undoubtedly. I remember very well discussing it with Mrs. Overton. It must have been about that time—I couldn't say whether it was 1938, 1939 or 1940 or maybe before—I remember saying to her, 'I made a mistake when I drew a lease and provided for termination at the end of the fiscal year instead of the school year.' So I am quite sure that was contemplated. Legally, Miss Blake had to hold it until the end of August.

(Narrative Testimony of Eugene Overton)

Q. "And, also, under her agreement, she had the duty to renovate and repair for the next school year?

A. "Yes.

Q. "In other words, any change you made of the nature you described here would have been a financial detriment to the corporation and a benefit to Miss Blake?

A. "It would have been a financial detriment to the corporation in that it had to pay those expenses but it would have been more than offset by having the management and enrollments. That would have been an extremely awkward position for the corporation.

Q. "The corporation could have hired their teachers through the coming years?

A. "I think you will find that would be absolutely impractical. If Miss Blake had still continued handling that school, things would have been in a mess. Mrs. Overton can explain that better than I can but I know it.

Q. "You have stated on direct examination that you conducted an investigation relative to the resident situation—

A. "Pardon me; I wanted to give you something else from these records. I found that, in 1939, there was no particular discussion or controversy or anything. There was quite a controversy with Miss Blake in 1940. She wanted some very material concessions in rent and so forth, which were made in part, but the situation was not such that we at that moment had the right to terminate the lease had we wanted to.

Q. "It was actually in your fiscal year ending August 31, 1940, that you changed the terms relative to sharing in profits and fixed rental?

(Narrative Testimony of Eugene Overton)

A. "Yes; we made at that time very material concessions. I have (T. 183-184) [31] that here.

Q. "And this argument with Miss Blake didn't reach any serious point until during the fiscal year ending August 31, 1940, did it, especially in regard to her maintenance of the school and the grounds and the painting?

A. "I don't understand your question.

Q. "Your serious difficulties with Miss Blake, that compelled you, in your judgment, to realize that you were to operate that school, arose during your fiscal year ending August 31, 1940, did they not?

A. "No. I don't know where you get that idea, Mr. Bryant. All through the years that Miss Blake was there, we had many, many discussions and much correspondence as to changes and concessions that Miss Blake wanted, and many of which we conceded. Now, in 1940, there was another one of those occurrences but we had no serious difficulty at that time. We had a little, as I recall—we got a little acrimonious but nothing serious and it was not until, I think it was, very early in 1942 that we definitely, or maybe earlier at the end of the preceding year, decided to terminate the lease. Mrs. Overton and I had been wavering for several years.

Q. "When Miss Blake requested that you waive your share in the profits and that you accept a reduced fixed rental,—

A. "And we did it.

Q. "—you had a rather considerable debate at the time, did you not?

A. "Yes; and that is all shown by the correspondence. But I don't think that was in answer to your question.

(Narrative Testimony of Eugene Overton)

Q. "Not the former one; no. During the fiscal year ending August, 1940, you had actually received factors which later tended to make you terminate this lease, is that correct?

A. "No; that is not correct. Pardon me for contradicting you that way. But the fact that Miss Blake wanted concessions, financial concessions, isn't what interested us so much. It was always our idea, and was then and still is, to try to have that school perpetuated as a very high grade school. Frankly, the financial end or remuneration was secondary. And had—I don't quite like to say this because we always have been very careful in what we said— (T. 184-186) [32] but had we felt that Miss Blake would continue to run that school as we thought it ought to have been run, we would have made a very substantial concession. So that was not the main consideration. Our whole aim during the years has been to try to perpetuate that school in the standards that it was run by Mrs. Overton's mother.

Q. "You conducted an examination as to the relative areas from which your pupils were drawn, did you not?

A. "Yes.

Q. "During those years the corporation was not operating the school?

A. "Not operating it actually. It was only supervising or had a supervisory control.

Q. "Did you investigate the various locations from which your pupils came?

A. "When do you mean?

Q. "During the taxable years.

A. "All the taxable years?



(Narrative Testimony of Eugene Overton)

Q. "1939 and 1940.

A. "I don't remember. I had Mrs. Overton have a map made, one that is for the purpose of sticking pins in, a map of the whole area around here, for one year. I forget which year that was.

Q. "That was in 1943, was it not, Mr. Overton?

A. "For the year 1943?

Q. "That was in the year 1943, was it not, that was first made?

A. "I don't remember what year it was made in or what year it represented.

Q. "Is it a matter of fact from your studies that your attendance from Pasadena, San Marino, and San Gabriel Valley increased while the attendance from intermediate points decreased, that is, those portions east of the school?

A. "That I can't answer. I made this study just recently. I don't know whether that is an exhibit or not. Is that in evidence?

Q. "That is an exhibit to the stipulation.

A. "I did this. I got from the school a roster of the students for (T. 186-187) [33] each year beginning with 1922. Isn't it in the stipulation?

Mr. Kumler: "1923.

A. "That was as far back as their records were accurate. That had the names and addresses of the girls in most cases. That tabulation is not, your Honor, an absolutely accurate tabulation for this reason. Some of the addresses were missing and they could not be found, a very few, particularly a few in the early years. In those years there were boarding pupils. Those I did not include in the tabulation because they might come from New York or any place else. They didn't figure in what

(Narrative Testimony of Eugene Overton)

we were studying. And then I omitted those who were living on Rossmore Avenue, and there were quite a few, because that was the dividing line. Then I went through most of them myself and put in blue or red pencil where I knew the streets, "E" or "W," for east and west. Those that I didn't know I gave to my secretary who had a large map of this area and had her mark "E" and "W" as to those where I didn't personally know the streets, and from that we tabulated the number year by year that were east and the number year by year that were west.

Q. "And isn't it a matter of fact, Mr. Overton, that the pupils of the Marlborough School could be located in bunches? If we put pins in the map for their home residences, would you have clusters of pins in various areas?"

A. "That may be so; I don't know. I didn't make that kind of a study. I can say this, that, in making those lists, I noticed that the tabulations—let me look at that tabulation. Take the latter years—have you seen this, your Honor?"

Mr. Bryant: "It is Stipulation No. 2, your Honor, page 3.

The Court: "Stipulation 2, what page?"

Mr. Bryant: "Page 3, your Honor, 'Marlborough Population Trend, Day Students.' This excludes the boarding students that were resident at the school.

A. "In 1923, for the school year 1923-1924, there were 260 pupils living east of Rossmore and 74 living west of Rossmore. Going on down, there is a rather definite trend and a rather consistent one to the westward.

(Narrative Testimony of Eugene Overton)

Q. "Yes, Mr. Overton.

A. "In 1930-1931, you will note that it is about even; that it is a (T. 187-189) [34] hundred each way.

Q. "I am trying to save the time of the court in regard to this. We have stipulated that your books would show that which is set forth on your trend. But what I want to know is, to explain this stipulation, do you have groups of pupils, in other words, the corporation? Isn't it a fact that the school is surrounded by the residences of the pupils and the majority of them are even today within a radius of a few blocks, with a cluster of Beverly Hills, a cluster in Westwood or West Los Angeles, and a small cluster in Pasadena and in the San Gabriel Valley and a few in the San Fernando Valley?

A. "If you say that is a fact, I will accept your statement. It would sound reasonable. I don't know and I don't remember what that pin map showed but it does seem to me that it did show some clusters.

Q. "Your tabulation took no account of those clusters?

A. "No account of those clusters. We were not interested in that and we are not today. What we are interested in is the general shift west and whether or not, to meet that shift, we have got to move the school.

Q. "Your pupils come from the class with more means than the average, do they not?

A. "On the whole, I think that is so; yes.

Q. "And the ultra—I shouldn't say 'ultra'—are so-called upper middle class?

A. "I wouldn't want to classify them but they come from the generally well-to-do class.

Q. "And those persons as a rule live in selected areas?

(Narrative Testimony of Eugene Overton)

A. "That is correct.

Q. "Among those families there is usually transportation facilities available, is there not, except during the period of rationing and national emergency and so forth?

A. "I haven't followed that angle. I think Mrs. Overton knows more about how the girls get to school than I do. I do know that during the wartime it was quite a job for a lot of them. I have heard Mrs. Overton discuss it.

Q. "You are willing to agree, however, that the automobile has (T. 189-190) [35] facilitated the attendance of your day pupils?

A. "Yes; I notice that the automobile congestion here is awfully bad.

Q. "In 1939, did you consult any engineers or architects in regard to the cost of replacing the main building?

A. "No.

Q. "Did you in any year prior thereto, since 1934?

A. "No; not directly, Mr. Bryant, as to the school. I think I generally keep myself informed as to the general trend of expense, that is, whether building costs are higher than they were or lower than they were and so on. I talk with contractors a great deal and I very often question them on those things. So I think I was generally informed. Or I will put it this way. I knew that for a good many years the building costs had been increasing very materially. For example, I remember I discussed that quite at length with Mr. Bill Simpson, of the William Simpson Construction Company, whom I see at lunch quite often, and people like that; but as to a definite study with reference to the extra cost to Marlborough, no.

(Narrative Testimony of Eugene Overton)

Q. "You arrived at no definite sum, within a thousand or so dollars, that would be necessary for the cost of replacing or remodeling your buildings?"

A. "No.

Q. "Your plan was not sufficiently definite to enable you to do that?"

A. "No.

Q. "In regard to your loss due to earthquake, you have estimated that to be the sum of \$20,000 for one year in one of the policy memos which you have introduced. How did you arrive at that sum?"

A. "You might call it a guess on my part or an estimate.

Q. "As to your estimate in regard to operating expenses, as it was prepared on November 7, 1939, how did you arrive at that?"

A. "Which item is that?"

Q. "I believe that is Exhibit 2.

A. "I think I have testified as to all of that. To run the school during the year, during the summer months, costs twenty to twenty-five thousand, and then the balance was for renovations and replacements that would have to be (T. 190-192) [36] made and all of those things. I think I went into that quite fully yesterday.

Q. "In arriving at that figure, did you include therein the cost of teachers, salaries for teachers and salaries for employees?"

A. "For the summer months; yes.

Mr. Kumler: "Which figure is that, Mr. Bryant?"

Mr. Bryant: "The \$50,000.

A. "The operating cost of twenty to twenty-five thousand is for the actual operating of the school during those



## (Narrative Testimony of Eugene Overton)

months. In other words, the pretty well known expenses would include certain teachers' salaries that were kept during the summer, permanent ones, and things of that kind.

\* \* \* \* \*

"We filed tax returns for the corporation, myself and my wife for the taxable years in question. Defendant's Exhibit D, the corporation's tax return for 1940 was prepared by Price, Waterhouse. I do not recall the question asked in the return regarding ownership of the stock. (T. 193.) It is correct, as the answer in the return states, that Eugene Overton, owned 50 per cent of the stock and that I acquired it in 1927. A couple of my partners held shares of record to permit them to act as directors. But those shares actually belonged to Mrs. Overton or me. The statement is true that the two of us owned 50 per cent [each] of the shares. I don't know if I stated that I owned the stock beneficially. (T. 194.) If such inquiry were propounded for the year referred to in that exhibit my answer would be that no one has any beneficial interest in the stock but Mrs. Overton and myself. I did not own the stock as trustee. Nor for Mark Overton. I own that as my separate property under the agreement of 1923. (T. 195.)

"You stated that stock was acquired by me in 1927. Yesterday the court called my attention to the fact that I had stated that the agreement was made between Mrs. Overton and myself in 1923, and Mrs. Caswell didn't die until 1925, at which time Mrs. Overton inherited the stock, and the two dates didn't jibe. I said that some time later I came into possession of that stock. You have just called

(Narrative Testimony of Eugene Overton)

my attention to the fact or stated it was 1927. That was to carry out the agreement that Mrs. Overton and I made in 1923 to divide everything equally. At that time I had some oil interests that were my separate property (T. 193-196) [37] and I gave her half of it. And later she conveyed a half to me, and then the other things we had were divided equally in that way.

“The reserve fund we were trying to build up was maintained either in cash, bonds or stocks. (T. 196.)

“During the year 1939 the business of the corporation was to own, control and eventually operate if it became necessary, as it did, the school. As to what the corporation did: As president I had conferences with Miss Blake during 1939 and 1940 and years prior and subsequent. I supervised the investments in stocks and bonds, and so forth, to a certain extent and discussed things generally with Mrs. Overton and probably had some correspondence in connection with other matters and supervised the financial matters and answered the questions of the auditors and a lot of things of that kind.

The Court: “May I interrupt here to say it is not clear to me what was involved in that part of the business of the corporation which you conducted either with Miss Blake or anyone else connected with the school. Can you tell us a little bit more about the nature of your activities in that regard?

A. “Do you mean with relation to Miss Blake?

The Court: “With relation to the school. You said you had conferences from time to time with Miss Blake?

A. “Yes.

The Court: “Now, can you tell us something more about the nature of those conferences, what they had to do with the school business?

(Narrative Testimony of Eugene Overton)

A. "Yes; I can, your Honor, to some extent. So far as the financial matters connected with the school or connected with her lease were concerned, those were under, you might say, my direct supervision. I discussed them and had many conferences and much correspondence with Miss Blake in connection with them. She would come to my office quite frequently and I went out to see her occasionally to go over her financial operations; and many times she wanted either her rent reduced or her salary that she was allowed to draw increased, and I handled all of those matters. I am trying to touch this generally. I have, as I say, a mass of correspondence on that and can go into detail if your Honor wishes any more. As to the academic end of it, the policy as to school matters (T. 197-198) [38] that came up, I let Mrs. Overton handle it with Miss Blake. Miss Blake has quite frequently come to our house for dinner and discussed matters. I was usually there at those conferences. But, if any academic question was involved, I sidestepped it or left it to Mrs. Overton. Questions of policy were discussed between the three of us on numerous instances or occasions. Miss Blake would want to do this or that, and I think in most cases we approved but in a few cases we did not.

"In running through this correspondence just now, as an illustration, I found a pencil memo that I made back a good many years ago as to a conference with Miss Blake.

Q. By Mr. Bryant: "During the taxable year of 1938?

A. "No.

Q. "I think you should limit yourself to that.

(Narrative Testimony of Eugene Overton)

The Court: "I am inclined to suggest that that perhaps would be inaccurate because let us assume, merely for the purpose of this discussion, that in the taxable years 1935, 1936, and 1937 the corporation actually operated the school in every sense of the term, and during the fiscal years 1939 and 1940, because of a policy to give the lessee another chance to see if she would conform, no such considerable activities took place. I would be inclined to rule that both sets of circumstances should be considered by the court. And, therefore, I think the portion of the testimony to which the witness is about to refer would be admissible.

A. "This is a pencil memorandum I made on November 20, 1931, headed 'Memos to Conference with Miss Blake.' November 20, 1931, I had a conference with Miss Blake, at my office, relative to the financial condition at the school and probable deficit for this year 1931-1932. We discussed reducing salaries and rent. I advised reducing all salaries by an horizontal percentage cut and said that we would make an equivalent reduction in rent but that we would like to have a modification of the lease, giving us the privilege of terminating it on a six months' or a year's notice. I gave to her reasons that we were not entirely convinced that the goodwill of the school was being maintained by her; that we hear much criticism and that, though we feel that where there is so much (T. 198-200) [39] smoke, there must be some fire, we are not convinced that the decrease in attendance is due to falling off in goodwill; that we are not sure the boarding department should be maintained. I told her that the only definite complaint we had to make was we did not feel she had complied with the provision in the lease as to



(Narrative Testimony of Eugene Overton)

having a competent vice-principal; that we had no present intention of terminating the lease but desired to be in a position to do so if we did find it necessary. Miss Blake agreed verbally to this modification of the lease and, as she was leaving, said she would like the privilege of doing the same. I said, "That is only fair." It has my initials, "E. O." I have stated that as illustrative of some types of talks I had with her. That was not carried out, by the way, that is, as to having the privilege of terminating the lease on six months' notice. She decided not to do that. The financial condition at that time was quite bad.

The Court: "Can you locate either any memoranda or correspondence relating to some period later than 1931-1932?"

A. "Yes; I think so, your Honor. We had a modification of the lease dated the 28th of March, 1933. At that time Mr. James A. Gibson was advising Miss Blake. I have some correspondence from him.

The Court: "Does that relate to anything other than the matter of rental or does it cover the subject matter of salaries and other expenses involved in the operation of the school itself?"

A. "It is rather long, your Honor. It involved a change in the rental terms or the proportion of the profits that she was to pay, which involved she pay the corporation 50 per cent and thus changed it to 50-50; that is, she took 50 and the corporation took 50. Well, wait a minute. Pardon me, your Honor.

The Court: "I was more interested in any correspondence or other documents that have to do with something other than the rent to be paid by the lessee.

A. "This gave her a right of renewal for five years and provided for a certain budget that she should prepare.



(Narrative Testimony of Eugene Overton)

The Court: "What is that about a budget?

A. "On some date subsequent to the opening of the school in 1935-1936, but not later than the 10th day of October, 1935, Messrs. Price, Waterhouse & Company (T. 200-201), [40] or some other firm of accountants satisfactory to the lessor and the lessee, usually prepared a budget of income and expenses for the full school year beginning September 1, 1935. "The income from tuition shall be based upon the number of pupils, both boarding and day pupils, shown by the records to be enrolled at the commencement of the school year 1935-1936, at the then prevailing rates. All other items of income and expenses shall be based upon the statement of income and expenses prepared from the records, verified by the firm of accountants, for the school year ending August 31, 1935, adjusted to allow for necessary increases or decreases in accordance with the information then available and the requirements of the usual operation of the school. A copy of said budget shall be furnished to the lessor and the lessee and, if the budget reveals that the operation of the school will permit the payment to the lessor of the fixed rental provided by Article IV of said lease (excepting the payment to the lessor of any profit from the operation of said school), without the school standing any of the loss from operation, then at any time, on or before the 10th day of November, 1935, the lessee, being in possession and not in default of said lease, shall, at her option, during the said period have the right to renew this lease for an additional term of not less than five years from the 1st of September, 1935, but not longer than to September 1, 1945, on the same terms and conditions as provided in the said lease and supplemental agree-

## (Narrative Testimony of Eugene Overton)

ments thereto, excepting that she shall be obligated to pay to the lessor, during the period for which this lease is renewed, 50 per cent of the net profits of said school for each fiscal year instead of the varying percentages referred to in Paragraph V." Then she shall have the right to take up herself the remaining 50 per cent. 'If said budget reveals that the operation of said school will result in a loss for the school year 1935-1936, after the payment to the lessor of the fixed rental provided by paragraph IV of said lease (exclusive of the payment to the lessor of any other profit through the operation of said school), then the right of the lessee to renew said lease for the additional term shall be subject to the right of the lessor at any time during said extended term to cancel and terminate said lease upon giving to the lessee written notice thereof on or before the 1st day of March of any year; such cancellation and termination to be (T. 201-203) [41] effective 30 days after the close of the then current school year.' That is the end of that paragraph, your Honor, in that portion. I don't know whether that is what you want or not.

The Court: "During the subsequent years, that is to say, subsequent to the making of that modification in the lease, was the practice followed of having a budget submitted by the fall of each year and having the same studied and considered by either yourself or Mrs. Overton or both of you?

A. "I can't say that that practice was followed. I can say that Miss Blake would come to me, at more or less frequent intervals, with a budget that she had prepared as to her operations or as to prospective returns and so forth and go over it with me. Now, there was no

(Narrative Testimony of Eugene Overton)

stated time; it was no definite time; but I know it was done quite frequently.

Q. "During each of the subsequent years?

A. "I would think so, your Honor. My records wouldn't show that but I would say there wasn't a year passed but I didn't go into those things with Miss Blake.

The Court: "Do I understand that your files also include some correspondence with the school relating to one or more matters pertaining to the operation of the school? In other words, what did you write to her about and what did she write to you about, if there was any correspondence?

A. "There was a great deal of correspondence. Most of it was with reference to the financial situation, quite voluminous on that.

Q. When you say "the financial situation," what do you include? Something more than rents?

A. "Practically all of it, your Honor, was, although there may have been some exceptions to it, because Miss Blake was seeking a reduction in rent or an increase in her share of the profits or because she felt that salaries should be changed. You see, in the lease we had provided or we wanted the standard of salaries maintained. We had provided there should be no change, either a decrease or increase in salaries without our approval. In two or three instances that came up. I think there is correspondence on that. I am quite sure there is. I know I had a number of conferences with her. One of (T. 203-205) [42] them is evidenced by that memorandum and also subsequent to that. During the years after the crash of 1929 and for a number of years, Miss Blake was having a rather hard time financially. So she took up

(Narrative Testimony of Eugene Overton)

all of those things with me and I approved or disapproved. As a matter of fact, I think in almost all instances I approved.

The Court: "I didn't mean to take the witness away from counsel but we have gotten into a phase of the testimony that I felt should be at least clarified and I tried to do that, I hope, to the satisfaction of counsel. At least I think I understand the situation better.

A. "I remember now one other incident that occurred at my home with reference to the operation of the school. Miss Blake—

The Court: "Do you recall about when this occurred?

A. "My best recollection would be about seven or eight years ago; I am not sure of that. Miss Blake came to the house one night and she wanted to use the school property during the summer months for some purpose other than strictly for girls' school purposes or school purposes, for something that she had in mind. I think it was of a more or less public nature, meetings or something of that sort. And I told her that she couldn't do it. There were a great many things of that general character that I do not remember the details of. The reason I told her she couldn't do it was because the restrictions wouldn't permit.

The Court: "Proceed.

"The school itself has been operated at its present location since 1916. It has built up quite a reputation among people particularly in Windsor Square, so that a great number of people send their children to the school. Its scholastic standards are considered very high. (T. 206.) The business has a substantial goodwill. I have never considered the value of the goodwill of the school and corporation, as such, in dollars and cents, in the event of a



(Narrative Testimony of Eugene Overton)

sale of the school. I would not attempt to put a value on goodwill on a thing of this kind. I don't believe in setting up goodwill on a corporation's books particularly in a business that is personal and subject to being defeated by poor management and the personalities involved. The goodwill of a school (T. 206-207) [43] depends entirely on the management at the time. (T. 207.)

Q. "Did you lease the school and put in its goodwill to Miss Blake?

A. "Yes; I suppose the lease would be a lease of the goodwill and the school.

Q. "As a matter of fact, that is called for in your lease, is it not?

A. "I don't remember.

The Court: "Can't we refer to the lease?

Mr. Bryant: "We can, your Honor. However, I have a reason for this.

The Court: "Yes; very well.

Q. By Mr. Bryant: "That goodwill went into the valuation of the rental of the school, did it not?

A. "No. The rental of the school when we approved that original lease—I don't know whether you have the original lease or not that was made by Miss Blake in 1925. Is that the one you are referring to?

Q. "Yes; I have.

A. "That was based solely on what we believed the school, with proper management, would be able to earn.

Mr. Bryant: "This lease is dated September 1, 1935.

A. "The original lease was 1925, I think it was. It was along the same lines and the rental provided for was based on what we knew the school, based on its past record, could earn with good management and no good-



(Narrative Testimony of Eugene Overton)

will as such was charged in taking into consideration the rental. It was its past earnings and the earnings it could continue to make.

Q. "Then, you didn't rent to Miss Blake a going concern?

A. "Oh, yes; definitely.

Q. "What would you put the value of that going concern as as against the value of the physical structure?

A. "I never figured it that way. I knew what the school had been doing under Mrs. Caswell's management, financially, and I sat down with Miss Blake, Mrs. Overton and I, and had many conferences. And Mr. Herbert Googe, who represented her at that time, went over those things and determined what would be a fair rental based on past experience. I don't think the question of goodwill (T. 208-209) [44] ever came into it. In that original lease she had an option to purchase and it may be that that lease provides that, upon payment of, I think it was \$25,000 after a certain period of years, she could purchase the school and its goodwill or something of that sort; but, in determining the rental, there was never any discussion of goodwill and the rental was not based on a determination of goodwill in the sense that I think you mean it.

The Court: "May I interrupt here to inquire, not for the purpose of shortening the cross-examination, do you feel that the cross-examination will still be somewhat extensive of Mr. Overton?

Mr. Bryant: "No, sir.

Q. "Mr. Overton, I will show you a copy of paragraph 9 of the lease, dated September, 1935, option to purchase.

A. "Yes. Shall I read it?

(Narrative Testimony of Eugene Overton)

Q. "No; just read it to yourself.

Mr. Bryant: "This is page 11 of the Stipulation of Facts No. 3, your Honor.

A. "Yes; I have read it.

Q. "Does that refresh your recollection as to the possible placing of a value at any time upon the goodwill of the school?

A. "No; that just bears out what I said a moment ago, that in the lease I thought there was a provision, and I think the same thing substantially appears in the original lease, that she could purchase the goodwill and so forth of the school upon payment, after a certain time, of a certain amount of money, \$25,000. But your question, as I recall, was as to the fixing of the rental and was that based on goodwill, and that was not.

Q. "It was not considered in fixing the rental?

A. "Not at all.

Q. "And did you ever value the goodwill of the corporation or the school?

A. "On the books?

Q. "No; place a valuation on it.

A. "No; nothing excepting as there stated; and that was just taken (T. 209-211) [45] out of the air so as to make a consideration for the purchase price of the school if she wanted to purchase it. Here was the purpose of that, Mr. Bryant. When we first entered into the lease with her after Mrs. Caswell's death—she, by the way, had been vice-principal under Mrs. Caswell—we came to an agreement with her, afterwards reduced to writing, that she should pay a certain rental. That, as I say, was based on the experience, the financial experience, of the school. Then she wanted the right or maybe we offered the right

(Narrative Testimony of Eugene Overton)

—I don't remember that—to purchase the school after a number of years. My recollection is she wanted the right to purchase the school at any time and we wouldn't give it to her because we wanted to be sure it was being properly run for a number of years before we let it go. But we did finally concede the right to purchase after a number of years, and I put in the provision in the lease that, for an additional payment of \$25,000, which was nominal, she having paid her rent during the previous years, she could purchase the goodwill. And I think the first lease gave her the buildings and furniture. I am not sure about that.

Q. "And this lease also carried the right to purchase the buildings?

A. "Yes; this lease was changed at that time. That provision was different, I think, in that respect and I think that provision was put in by Mr. Gibson.

Q. "I couldn't hear you.

A. "I think there was a provision put in by Mr. Gibson, although I am not sure of it.

Q. "But you never placed on your books and in known figures in this case does the goodwill enter into the policy of the school?

A. "Never.

Q. "You never considered that?

A. "I never had it on the books. There has never been any valuation on the books of the goodwill, or, if it was done, it was done without my knowledge.

Q. "On direct testimony, Mr. Overton, you stated that among the factors that you considered in connection with your fire loss and your earthquake loss was the item of paying teachers and help in the years 1939 and 1940. As

(Narrative Testimony of Eugene Overton)

a matter (T. 211-212) [46] of fact, you had no obligation or duty to pay either the teachers or the help, did you?

A. "I didn't say, if I recall correctly, and, if I did, I didn't mean to say it, that we expected to pay teachers and help in 1939 and 1940. That estimate was made based on the time that we should take over the management of the school, the complete management of the school; that then we would have to pay those things.

Q. "Mr. Overton, you and Mrs. Overton have income besides that which is recovered from the school, have you not?

A. "Yes.

Q. "And that was stated upon your income tax returns for the years 1938, 1939, and 1940?

A. "It must have been. Neither Mrs. Overton or I prepared those returns but I think at that time Mr. Ira Frasier [Frisby], an accountant who specializes in that work, was doing that work for us. He prepared them.

Q. "From the figure which you gave him?

A. "Yes; from our books.

Q. "You have numerous investments and securities, have you not?

A. "Personally, do you mean?

Q. "Yes.

A. "I have some; quite a few.

Q. "Do you have an estimate as to the yield on those investments percentagewise during the taxable years 1938, 1939 and 1940, that is, the calendar years?

A. "No; I couldn't give you that.

Q. "Would you say that you received 5 per cent or 6 per cent or any other figure?

(Narrative Testimony of Eugene Overton)

Mr. Kumler: "If your Honor please, I hardly see how this is within the scope of cross-examination unless counsel can explain what he is directing his questions to.

The Court: "Will you enlighten us?"

Mr. Bryant: "I wish to see the relation between the interest on the (T. 212-214) [47] investments of the Overtons and the return that they made upon their loan to the corporation, that is, the notes that are payable. You remember there is a 7 per cent return on those.

Mr. Kumler: "I still fail to see any connection with the matter in issue in this case, your Honor.

Mr. Bryant: "A part of the issue in this case, your Honor, is the question of a corporate pocketbook and I believe—

The Court: "There may be some basis for argument there. I think I should allow the question. Mr. Reporter, will you read that question again?"

(Question read by reporter.)

The Court: "What amount was invested in securities? Is that your question?"

Mr. Bryant: "That is correct, your Honor.

A. "I can't answer that for this reason: My investments are not made from the standpoint of interest earnings. My investments are made, and, incidentally, I employ and Mrs. Overton employs and the Marlborough Corporation employs, an investment counsellor, Mr. Lee A. Paul. He makes the investments for us more from the standpoint of whether or not the stocks or bonds are liable to increase or decrease in value and the profit or the loss made from that standpoint, hoping, of course, it will be a profit; and the interest is a secondary consideration. Therefore, I haven't paid very much attention to the interest.



(Narrative Testimony of Eugene Overton)

Q. "Do you pay much attention to the yield?"

A. "Do you mean as to whether they make a profit or not?"

Q. "That is right."

A. "No, frankly, I don't. I discuss it with him every now and then. He comes to the office or he calls me up and says, 'No, this is my policy; I think I had better sell this stock and take a loss, and I had better sell that and make a profit,' and gives me his reasons. We discuss the general investment policy. I am speaking now as to my own and the corporation's. I pay no attention to Mrs. Overton's. I don't even know what she has. I couldn't tell you today what stocks he has purchased or sold for me within the last three months. (T. 214-215.) [48] Of course, I have it in my records but I couldn't tell you that."

Q. "Mr. Overton, are you familiar with Schedule E of Defendant's Exhibit D, the corporation income tax return, of which I show you a copy here, listing certain stocks? Are you familiar with those stocks during the taxable year ending August 31, 1940?"

A. "These are, I assume, stocks owned by the corporation at that time. Isn't it?"

Q. "I believe that is true."

A. "That is the purpose for which they were included in that return or the apparent purpose, I should say. You ask me if I am familiar with them. I think I recognize the names of all of those companies and securities."

Q. "Are any of those stocks connected with the business of the Marlborough Corporation?"

A. "How do you mean?"

Q. "Are any of those firms accomplishing the same purpose or doing the same work that the Marlborough

(Narrative Testimony of Eugene Overton)

Corporation is doing? Do those stocks by themselves further the corporate purpose of the Marlborough Corporation except as investments?

A. "No; these stocks are stocks and bonds in the reserve fund that I have been building up and which I and our investment counsellor feel are liquid stocks and good for investment. And the purpose of all this investment is to build up and retain that fund we have been discussing so much.

Q. "They have no connection with the purposes of the corporation?

A. "Do you mean with the operation of the school?

Q. "Yes.

A. "Not with the direct operation of the school.

Q. "Nor with your operation insofar as you are concerned of the school?

A. "Well, only insofar as that, if we need a certain amount of money for any contingencies I have talked about, we can sell these stocks and get the money just as if we carried it in the bank.

Q. "Is that also true as to the bonds and stocks listed upon Schedule C for the year in question? (T. 215-217.) [49]

A. "All of the securities, Mr. Bryant, are for that purpose. Let me say again it is just exactly as if the money were in bank, as a considerable sum is.

Q. "In other words, the corporation was engaged in investing its surplus in stocks of other companies for the purpose of gaining a higher yield than that received from banks?

A. "Yes; and thereby building up the reserve.

Mr. Bryant: "No further questions." (T. 217.) [50]

\* \* \* \* \*

## GEORGIA OVERTON,

a witness for the plaintiff, being first duly sworn, testified as follows:

## Direct Examination—Georgia Overton

"I was brought up in the school business from the time I was a baby, and taught at the school for five or six years. Unofficially, in many ways I was vice-principal to my mother. She discussed everything and her plans with me over the whole period she lived. After I was married and lived away from the school, I was here constantly while she was alive, and a great deal after Miss Blake took the school. (T. 241.) It was I who really decided on Miss Blake as principal after my mother died.

"I am now principal. I took over the buildings on the 15th of June 1942, although I had done some things like talking to teachers or employees before the close of the school year.

"Marlborough School enjoys a very good reputation. We send a great many girls to colleges everywhere in the country, and our record with the colleges has been excellent. There is a California association of independent secondary schools, formed about 5 or 6 years ago, by some of the best schools for boys and girls in the State and their constitution provides for a board of standards appointed by the presidents of the different universities. Stanford and California are represented every year. At the beginning there was one other college (T. 242) Pomona. Later there were three other colleges. The other three members served for periods of three, four and five years, so there is a shift of membership or personnel of the other three. Those professors pass upon physical equipment, ethical practices and scholastic

## (Narrative Testimony of Georgia Overton)

achievement of the schools and may remove any school from membership on the approved list. Certain schools met to form the association and they couldn't be permanent members until they were passed upon by the board of standards. There were 63 applicants at the time and the board of standards accepted 21.

"Marlborough is rated at the very top. They judge on the record of pupils that the schools recommend to colleges. Their requirement is that 67 per cent of the girls recommended make a "C" average or better in their freshman year, and in the last three years Marlborough's record has been 93 per cent. (T. 243.) [51]

"With the assistance of two of my vice-principals, I supervise the upkeep of the school properties. During 1939 and 1940, while the lease was in effect Miss Blake looked after the condition of the properties. To the extent of my ability, I saw to it that the provisions of the lease were observed by the lessee. As I understood it the corporation had nothing to do with the upkeep of the school other than objecting to expenses. (T. 244.)

"During the taxable year 1939 and 1940, I, after consultation with Mr. Overton, performed the functions of determining what facilities were needed or not needed in connection with the school.

"Based upon indications in the years 1939 and 1940, the condition of the school properties, as compared with (T. 245) normal conditions (T. 245), showed that a good many things were needed. The gymnasium was extremely old-fashioned compared to any school that might have been built at that time and in a good many ways inadequate in the matter of showers and dressing room space.



(Narrative Testimony of Georgia Overton)

And there wasn't any refrigerating plant. In the general school buildings, there was some inadequacy in the size and number of classrooms. The possibility of eliminating the boarding department would have involved quite a great deal of remodeling. (T. 246.) In doing away with the boarding department it was contemplated that we would increase the number of day pupils and that many of the rooms that had been used for the boarding department would be converted into classrooms. Rooms, used as bedrooms, for example, would be converted into classrooms, which in all cases meant taking out partitions and throwing two bedrooms together to make one classroom. (T. 247.) The Junior high school would inevitably be enlarged in case the boarding department was done away with, and it would necessitate enlarging the junior high assembly room as well as making what we call home rooms where each girl has her own desk and keeps her books. Those have to be large enough to contain a certain sized group and it would mean throwing rooms together. That is quite a considerable thing and a good many rooms were involved.

"There are three wings to the building upstairs, the west wing which already had classrooms, the east wing which did not and practically the entire south wing would have to be converted into extra rooms, and throwing some rooms (T. 248) [52] together on the west wing.

"The interior of the rooms would have to be changed completely. It meant putting up black boards. Those rooms had been wall-papered and it meant taking that off and painting them and installing blackboards and linoleum on the floors, if you could get it. (T. 248.)



## (Narrative Testimony of Georgia Overton)

"As to extraordinary renovating needs during 1939 and 1940, practically the entire interior of the buildings needed repainting and redecorating and some external painting. A great deal of furniture was old-fashioned and a school has to be kept modern. The fabrics were not faded; they were in good condition, but there should have been new furniture purchased because it was outmoded and the effect was bad. The wallpapers which had been very good when put on had been there too long. They belonged to another era. I do know that the wallpaper in the main halls had been put on by my mother before 1924.

"The carpets were, in general, in good condition. There were some that should have been replaced. They were in bad condition. We have some oriental rugs.

"The drapes were old-fashioned and out-of-date and had been kept when they should have been changed (T. 249), to go with the other changes made. The effect was a very antique decorative scheme; both old-fashioned and patched.

"After we took over the school in 1942 we made all the renovations, repairs and remodeling anticipated in 1939 and 1940, except the refrigerating plant, the kitchen and the remodeling of the gymnasium, neither of which was possible under war conditions.

"The \$35,000 needed for additions to buildings and other facilities at the present location, testified to by Mr. Overton, included mainly, the gymnasium. That is partly sealed, perhaps you would call it a rustic effect, unfinished wood. The rest of it shows the joists, or studding, or whatever they are. And it is completely unfinished. It

## (Narrative Testimony of Georgia Overton)

makes it (T. 250) very dark with that color and it is impossible to paint, satisfactorily, the rough wood, that is left. We never did do anything with it and the least that should be done would be to seal the gymnasium and paint it. The shower baths and dressing rooms are inadequate; the shower baths are the original ones put in. (T. 251.) [53] If installed now they would be entirely different. They are rather like tin bathtubs. The dressing rooms are inadequate in that there just isn't room enough. The dressing rooms are used by the girls to change from their uniforms into their gym clothes. They should use lockers, but we haven't the space for lockers for their daytime clothes. (T. 251.)

"The need of space for facilities, which, Mr. Overton testified, was one of the considerations for considering moving the school in 1939 and 1940, including space for two more tennis courts, two more volley ball courts, a soft ball field and a swimming pool. There is no space for any of those on the present property or on contiguous property. We also needed ground for parking space. Some girls drive their own cars and we have no parking space except the driveway. The girls park all up and down Rossmore and that is bad from the traffic standpoint. Then the cars that come for the girls have no place to wait, except in the driveway, with the result that they are obliged to keep moving round and round. If a parent is there in a car and the girl is not immediately available, that car has to move on. (T. 252.) In the years 1939 and 1940, we had complaints on that situation. The driveway was enlarged at one time by taking a section off the lawn, but it was completely inadequate. There have been complaints always.

(Narrative Testimony of Georgia Overton)

“At the time the school was moved in 1916, Mrs. Caswell and I made a study of the population shift and it was one of two factors in our determination to move the school. One was the fact that the school buildings were old-fashioned and somewhat inadequate and the other was the shift in population. At that time the school was, roughly speaking, on the southeast corner of an oblong. She moved it to Third and Rossmore which was on the Northwest corner, on the theory that the population was moving in that direction and would soon go beyond here. (T. 253.)

“At present, less than half the students drive cars to school. Only junior and senior classes are allowed to drive. The others get to school on street cars, buses or are driven by some member of the family. This percentage would stand about the same for the year 1939 and 1940. The element of the distance which parents have to drive their children to school does have an effect (T. 255) [54] on the number of students who will travel. (T. 255.) I can't state whether any pupils came from the San Gabriel Valley because I haven't checked on that. The probability is that none did except as boarding pupils. At present we have only one pupil coming from San Marino. They moved there and the child was so desperate that she drives in from San Marino. And we have one other from Glendale.

“It is difficult to say what effect distance has on the number of students who enroll. If they don't enroll we can't count them. But distance and time enter in because school begins at 8:30 and even if the distance is not too great there are a great many families who don't care to get up early enough to get a daughter started an hour

(Narrative Testimony of Georgia Overton)

ahead of time, after she has breakfasted. So, unless they are determined she shall go to Marlborough, they normally send her someplace nearer.

“I am personally familiar with the details of expenses of operating during the summer months. (T. 256.)

(At this point counsel for the defendant stipulated to the expenses set forth on page 12 of the Claim for Refund for the year ended August 31, 1939, being defendant’s Exhibit “E,” as being reasonable figures for expenditure for any similar three month period.) (T. 257.)

Cross-Examination—Georgia Overton

By Mr. Bryant:

Q. “Mrs. Overton, during the period of 1939 and 1940, did the corporation have any power to make any additions to the property without the consent of Miss Blake?

A. “Do you mean building?

Q. “Yes; or alterations.

A. “No; or, incidentally, repairs. No; the corporation could have bought land.

Q. “But as to repairs or adding facilities, that could not be done, could it?

A. “No. (T. 257.)

\* \* \* \* \*

The Court: “May I inquire, would it be either desirable or practicable (T. 258) [55] to outline what we should look for during the inspection of the subject property?

Mr. Bryant: “I think it might be desirable, your Honor. I think the main reason for inspection is, in addition to the testimony of the witnesses, for your



(Narrative Testimony of Georgia Overton)

Honor to have an opportunity to determine the usable value of the buildings to get an opinion as to what the reasonableness of a businessman's opinion would be as to the length of time that those buildings might be used. As Mr. Overton stated on the stand, the fact that a building is full depreciated does not necessarily mean that it can no longer be used; and that, of course, would go into the reasonableness of the plan, in 1939 and 1940, of moving the school and the length of time in which the present buildings could be used. I think that is the only purpose of an inspection of the buildings. There also is that chart out there in regard to population, is there not?

Mr. Kumler: "Yes; there is.

Mr. Bryant: "Which is in the office. It was too bulky to bring to court and we thought, as long as there was a possibility that the court might go there, we could also inspect it at that time, not to be entered as an exhibit but merely for the guidance of the court, since it was prepared subsequent to the taxable years in question. But, however, the group relations would be relatively the same. I think the government is willing to stipulate that there is a trend on this westward development of the class of persons from which the clientele of the school is drawn, or perhaps it might be more accurate to describe it as a dispersement of the groups. If we have a group going to San Fernando Valley and Beverly Hills and Westwood and have another group going east into the San Gabriel Valley and into Pasadena, San Marino and Arcadia and San Benito Village, I think those are facts that the court could even take judicial notice of, things which are so familiar to all the residents of Southern California and especially with your Honor's long number of years here.



(Narrative Testimony of Georgia Overton)

The Court: "May I ask the reporter to read the last sentence in counsel's statement, the long sentence with reference to this population trend chart?

(Record read by reporter.)

The Court: "I am not sure that I grasp the import of your statement (T. 258-259) [56] as to what the court will take judicial notice of.

Mr. Bryant: "The trend in population development of the particular class that the school draws its students from. I think that is something that the court could probably take judicial notice of, and, certainly, a businessman could do so. We have had no argument with counsel in regard to the fact that there is a trend. The extent of it is something we have not introduced proof concerning. (T. 259-260.)

(At this point the hour of visiting the subject premises was agreed upon.)

\* \* \* \* \*

The Court: "I think that would be desirable. We haven't consulted Mrs. Overton, though.

Mr. Kumler: "I did, your Honor, and she consented. If your Honor please, counsel for plaintiff would like also to have you take particular note of the gymnasium, the shower rooms and the dressing rooms, on your visit, particularly those items. And also your Honor might inquire about the general appearance of the school properties as compared with 1939 and 1940.

Mr. Bryant: "Counsel is willing to stipulate there have been no structural changes since that time.

Mr. Kumler: "There have been remodelings.

Mr. Bryant: "I mean structural changes; that is, the main buildings have not been changed.

(Narrative Testimony of Georgia Overton)

Mr. Kumler: "There have been no additions, to my knowledge, in the floor space, no additional floor space added.

The Court: "Wouldn't it be advisable for someone to point out what changes have been made subsequent to the taxable years?

Mr. Kumler: "I think we will ask Mrs. Overton to do that, with your Honor's permission. (T. 260-261.) [57]

\* \* \* \* \*

MR. MORGAN ADAMS,

a witness for the Plaintiff, being first duly sworn, testified as follows:

Direct Examination

"I am in the mortgage business. I have been president of the Mortgage Guarantee Company and the Bond Investment Company since 1922 and vice president before that since 1913. I resigned directorship in the Title Insurance Company and Bank of America in 1931 or 2. As a director of the Mortgage Guarantee Company I am responsible for loans made by that company. All loans come to my attention. I have passed on loans of 200 or 300 millions since 1922. (T. 40-41.)

"I was connected with private school business from about 1917 until 1932 or '3 as trustee of Harvard School [for boys in Los Angeles]. I was a trustee of Catalina School for Boys and still am, from about 1926. As an officer and director of loaning institutions I have had occasion to consider and pass on private school loans. It is hard to say how many. Undoubtedly a great many

(Narrative Testimony of Mr. Morgan Adams)

applications for private school loans came to us over a period of years. Almost invariably these applications have been too high for us to consider. (T. 41-42.)

“Some of the applicants were the Girls Collegiate School, Black-Foxe Military Academy, and a school in Brentwood. I have forgotten its name. A great many applications came to us over that long number of years. (T. 42.)

“A school loan not only as a business risk but also as a real estate risk is very dangerous. They fall into the same category as a loan on a church or club. It has something to do, of course, with the background of the school, who is in it; their degree of success; but in general that is looking at it as a cold lending proposition. In the first place, the buildings are entirely one type of building. They can be used for nothing much except school purposes and the nature of the business is dangerous. So I think the general policy of any lending institution would be that the loan be based primarily upon the value of the real estate. While you might give some value to the buildings and some value particularly to the management and success of whoever was running it, yet the loan would be of a very conservative value if you threw in any value on the buildings. (T. 42-43.)

“Leaving out personalities or background and assuming the buildings had little or no value for other purposes, the limitation on the amount loaned would [58] be a conservative amount of the value of the real estate. (T. 43.)

“I think universally the Metropolitan Life Insurance Company, which we have represented for 20 years, won't

(Narrative Testimony of Mr. Morgan Adams)

consider one purpose loans of this type at any price. (T. 44.)

“In my capacity as trustee of private schools I have considered the desirability of borrowing money on behalf of such schools. We were approached in regard to making a loan to Harvard School, but didn’t do it. In 1926 Harvard School decided they would have to move from their then location. They had a comparatively large tract of ground on the corner of Western and Sixteenth about 700 by 700. They conducted not only a day school but also a boarding school. They had various vicissitudes. They purchased, and that was while I was still a trustee but I was away in the service, a very sizable piece of ground to which they expected to move on the corner of Beverly [now Sunset] and Sepulveda, about 20 acres. (T. 44.)

“My recollection is that they paid about \$20,000 an acre for that stuff, around \$400,000. They borrowed, for the purpose of making that loan [purchase], from the Pacific Mutual, around \$375,000 on their old property at Sixteenth and Western. They had a chance to sell that property to one of the big chain stores; the property at Sixteenth and Western. My recollection is that they were offered \$650,000 and the board of trustees turned it down, feeling they would get close to a million. They bought the Westwood property, or the other property, before they had completed the sale of the Harvard School property, feeling sure they were going to get a good price. Either the panic of 1929 hit them or the deal blew, so they couldn’t sell the old Harvard school property. They lost the chance. That is what broke them. They borrowed this large sum of money and they had this



(Narrative Testimony of Mr. Morgan Adams)

large piece of property in Westwood and they lost the chance to sell their property here where they were, and from there on down the Harvard School was nothing except a financial headache. The Pacific Mutual finally foreclosed on that loan, and I think the Pacific Mutual—by the time they foreclosed it was well in excess \$425,000—they sold the Westwood property for around \$50,000; that is, the Pacific Mutual did. (T. 45.) They sold the Harvard School property this year, which was carried all that time for around \$160,000 or \$170,000. In other words the Pacific Mutual took a loss in the neighborhood of \$200,000 on the loan and that was [59] apparently in contemplation of the move Harvard School expected to make. (T. 46.)

“Based on my experience as an executive officer passing on loans made by lending agencies and upon my experience as trustee of two private schools, my opinion from the business viewpoint of the preference of financing the cost of school buildings and facilities out of earnings rather than borrowing is that you had certainly better insure yourself against the necessity of borrowing.” (T. 46.)

Cross-Examination—Mr. Morgan Adams

“The rates of interest prevalent from 1916 to 1925 in regard to school loans, when, as and if granted, would be, say, 7 per cent. No reputable lending company would charge as high as 12 or 15 per cent, neither in 1916 nor 1924. (T. 46-47.)

“In 1939 interest rates were lower. Standard rates on regular run-of-the-mill business in Los Angeles would have been 5 per cent versus 7 per cent in 1916. The rate had not changed in 1940. This was a gradual decline in



(Narrative Testimony of Mr. Morgan Adams)

the rate of interest in Los Angeles over a period of years. (T. 47.) There was no more loaning money available in 1916, 1918, and 1922; just interest rates had changed, mainly due to interest on government borrowings, government bonds having dropped from 4 per cent to 2 per cent to 1 and  $\frac{1}{2}$  per cent. (T. 48.)

Mr. Kumler: "If your Honor please, I would like to have counsel clarify whether these questions are with respect to secured or unsecured loans."

Mr. Bryant: "To the type of loan we are talking about here, a school loan, which, presumably, would be secured. I don't think that anyone would probably grant a school loan unsecured, in the usual business."

Q. "Isn't that correct?"

A. "I am not in that business. Ours is the mortgage business."

Q. "You have testified only in relation to mortgage loans? You are not testifying as to any other type of loans?"

A. "I didn't think I would qualify. I am, primarily, a mortgage man."

Mr. Bryant: "That is all the questions I have." (T. 48.)

Redirect Examination—Mr. Morgan Adams

"The loans to which I referred in my testimony were all secured by first trust deeds on income and producing real estate. (T. 48.) [60]

"The opinion I express with reference to the preference for financing facilities out of earnings rather than out of borrowings would apply to any particular period of time as well as 1939 and 1940. [61]

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## JOHN C. AUSTIN,

a witness for the Plaintiff, being first duly sworn, testified as follows:

"I am an architect. I am not a graduate of any college or university. I followed apprenticeship courses and have no honorary degrees. (T. 49.)

(At this point counsel for the Defendant stipulated Mr. Austin's qualifications as an architect and estimating architect and that he had built a great many schools and similar buildings in the Los Angeles area.) (T. 50.)

"I have had occasion to consider the cost of construction of school-type buildings in 1939 and 1940; am familiar with such costs, and keep records of such costs. There was no substantial difference between the type of construction used in public and private school buildings in 1939 and 1940. (T. 50.)

"I am familiar with the buildings of Marlborough School at Third and Rossmore in Los Angeles. I designed and supervised construction of the Main building, Building No. 1, and the Music building, Building No. 2. The Music building is a combination auditorium, music building, and other things, classrooms and so forth. (T. 51.)

"I recently examined the plans and have been over the buildings at Marlborough.

"Based upon my experience and knowledge of school buildings and my knowledge of the size and character of the Main building at Marlborough, Building No. 1, it is my opinion that to replace it, about August 31, 1939, with a building of similar size and containing substantially the same facilities, you would not be allowed to build the Marlborough School as it was originally built. It was a

(Narrative Testimony of John C. Austin)

three-story building in part and a two-story in other parts. It was a frame building, and the laws so changed that in 1939 one would have to build a masonry building and the minimum type of construction in that year would have been masonry walls and fireproof corridors. You could have used wood in the construction of the roof and the floor joists to span the classrooms. If it were a three-story building, which Marlborough is, it would have to be absolutely fireproof or a Class A building. If it were a two-story building, you could have built it on the Class B type, which I have just described, and the cost would be very little different. A building of the same square footage or floor space, built three stories, just as the building [62] is at present, with the same general facilities as to classrooms, partitions, plumbing, and all those things necessary to a building, but under the conditions existing at August 31, 1939, comprising 48,058 square feet, would cost, in my judgment, \$5.31 per square foot, amounting to \$255,188. There would be practically no difference in such cost of replacement as of August 31, 1940, as distinguished from August 31, 1939. (T. 51-53.)

“Based upon my experience and knowledge of building costs and my knowledge of the size and character of Building No. 2, the auditorium [music] building, containing 14,182 square feet, it is my opinion that it would cost, on August 31, 1939, \$5.31 per square foot or \$75,306 to replace it by a building of similar size and character and containing substantially the same facilities, in the light of costs and conditions then existing. When built in 1927, it cost \$4.92 per square foot.” (T. 54-55.)

The Court: “May I interrupt just a moment? May I interrupt to ask a question here to see if I understand

(Narrative Testimony of John C. Austin)

this testimony? You have given us a figure of \$75,000 plus as the approximate cost for building the auditorium in 1939 as against a cost of \$69,000 plus for the year 1927. In giving us those figures, have you assumed that, in 1939, the building would be constructed exactly as it was in 1927 with respect to materials and the like?"

The Witness: "Yes, sir; it could have been constructed in 1939 almost exactly as it was constructed in 1927. We had built it of reinforced concrete and it was almost a fireproof building. That is why the cost is so different."

Q. By Mr. Kumler: "That is the auditorium you have reference to?"

A. "The auditorium. The actual cost was \$69,000 and I estimated it would be \$75,000 plus in the years later."

The Court: "Then, referring to the figures that you have given us with reference to the three-story building, I understand it was built in 1916 and is frame-constructed?"

A. "Yes, sir. Every bit of it would have to be torn down and replaced with something else."

The Court: "And this figure of \$255,000 plus as the cost, in August, 1939, would represent a Class A building, having a like size and facilities?" [63]

The Witness: "Exactly, according to the conditions and costs as they existed at that time."

Q. By Mr. Kumler: "Mr. Austin, you stated that the cost of the main building, No. 1, would be approximately \$255,188. Does that include the pergolas and terraces that went into the original main building?"

A. "No, sir; that was just the main building itself."



(Narrative Testimony of John C. Austin)

Q. "What was the cost of those other items, the pergolas and the terraces, originally?"

A. "That I don't remember and my records don't reveal it. I don't know whether they were part and parcel of the original cost of \$77,185 or not, but to reproduce them I have an idea as to how much that would cost."

Q. "Could you express an opinion as to the amount?"

A. "About \$14,000."

Cross-Examination—John C. Austin

"There is no equipment included in my estimate on the main buildings. I figured on the building; no lockers, no floor coverings and no electric light fixtures. Plumbing would be included as part of the building. Electrical fixtures were not in [the estimate] but the wiring would be in, including all outlets ready to attach the fixtures to." (T. 56.) [64]

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THOMPSON WEBB,

a witness for the Plaintiff, being first duly sworn, testified as follows:

"I am headmaster and half-owner of Webb School at Claremont. As headmaster I enroll the boys, look after the discipline and attend to the business. I am entirely in charge of financial affairs. One hundred twenty-five students are enrolled; a few in eighth grade but most in the four years of high school.

"For years I have been a trustee of Scripps College and on the Board of the California Junior Republic, which is something of a school as well as a home. (T. 57.) I was



(Narrative Testimony of Thompson Webb)

one-time president. I am a trustee of Webb School, my father's school in Tennessee, and a director of Pomona Hospital. I was for some years a director of the Los Angeles County Mutual Fire Insurance Company.

"I have been an owner and headmaster of Webb School of California since 1922. I was born and reared in my father's school at Bellbuckle, Tennessee. It was founded by my father originally, and my oldest brother operates it now. My father prepared more Rhodes scholars than any other American teacher, I was told by Dr. Aidelotte, who is head of the Rhodes Foundation in America, and Dr. Pennypacker, the Adams officer of Harvard University. There is a chart, carefully worked out, in his office (T. 58) of the standing of every school based on the academic standing of its pupils. Father's school was No. 1 and had the highest rating. In the writings of Woodrow Wilson you will find that he makes this statement about the record of father's school at Princeton University.

"I taught in the Webb School of Tennessee for years. I was summer school head for nine years and for four years was their bookkeeper. I am now a trustee.

"In 1922 my father's teachers were coming back from the war and I wasn't needed there. I was \$20,000 in debt, and I wasn't going to pull out by taking a salary in school and I had to do something. An opportunity came to buy a school in Claremont, California. They quoted a price of \$40,000, half cash. I negotiated with them until they cut the price to \$25,000 on the original 20 acres (T. 59) and the buildings and let me take it over for nothing. I was to pay for it out of earnings. That was in 1922.

(Narrative Testimony of Thompson Webb)

"I had no capital to start with, and \$20,000 indebtedness. I financed my expenses of operation from 1922 to 1930 by borrowing. (T. 57-59) [65]

"We now have 65 acres and 20-odd buildings and more than 40 employees.

"In the last few years we have entered in a team [competition] formed by the American Chemical Society, which is an examination. We have taken the first place in three years, including last June. We have taken second place twice and third place twice. Last year we entered a boy in the Westinghouse Competition offering a scholarship amounting to \$1,850 to the Carnegie Technical (T. 60) Institution of Pittsburgh. There were 690-odd contestants from 44 states, and our boy won one of the ten scholarships. At the end of the semester our boy had the highest record of the ten admitted. Six times we have entered the competitive competition for the Harvard National Scholarship and five times we have won, giving us the largest standing of any school of the West.

"Our school at Claremont was financed by borrowing and living out of profits. The borrowings were all paid on time; principal and interest never defaulted. (T. 61.) In financing the acquisition of land, buildings and equipment the funds required are gotten from borrowing or accumulations of earnings. In my experience as an operator of a school, paying as you go is the sounder [method]. It is much safer.

"My father advised me strongly against borrowing. He told me he had never seen a school that borrowed that didn't go broke, and yet I had to borrow and I fought through that line. But I don't know of another

(Narrative Testimony of Thompson Webb)

institution that has been able to survive and do it. It is much sounder business to acquire capital and then spend it rather than borrowing.

"I am familiar with the practice of schools in funding (T. 62) depreciation recoveries on school buildings and facilities. The American Council of Education, in Washington City, have issued a pamphlet called 'Financial Advisory Service of the American Society of Education.' Our school belongs in an honorary capacity. They point out that public institutions do not depreciate real estate; that they are not for profit and there is no purpose in depreciating them and that many eleemosynary institutions, depending entirely on funds, do not depreciate. But they make this point: 'The importance of maintaining inviolate the principle [principal] of the permanent funds represented by real property makes provision for renewals and replacements an essential part of the proper management of these funds.' (T. 60-62.) [66]

"If depreciation on any type of real property is taken, it should be represented by cash or investments earmarked and specifically set aside in replacement, or depreciation, funds.

"If depreciation is not funded, the sole purpose of providing for it in education institutions is defeated.

That is from the body of it. Their final conclusion is, "If it is expected that this property will be replaced out of the income of the activities, it is essential that depreciation be accounted for.

"If depreciation is taken, it should be funded, that is, cash should be set aside in replacement, or depreciation funds."

(Narrative Testimony of Thompson Webb)

The Court: "May I interrupt to inquire when that pamphlet was issued?"

The Witness: "In November, 1935."

The Court: "And have you kept sufficiently informed on the subject to be able to tell us whether or not there has been any modification of that statement?"

The Witness: "I have not seen any, sir."

The Court: "May I see it just a moment, please?"

The Witness: "I could get all of the bulletins, if you like."

The Court: "For the purpose of the record, will you tell us what is the American Council on Education, and something about its constituent membership?"

The Witness: "I don't remember when it was founded but I have heard it referred to for many years. It is composed of the universities and colleges of the United States. It was founded to assist them in every possible way and to keep them informed and to issue bulletins of importance. They employ experts in various fields and issue pamphlets which are useful to the educational institutions. It has only been in the last year or two that they have invited a few private schools to membership and it was considered quite an honor to be one of those invited."

The Court: "Of course, I haven't had time to read this bulletin but I notice it uses expressions like these on page 1, for example, the opening sentence: 'The problem of depreciation of buildings and equipment in educational institutions is one that gives considerable concern from time to business managers and financial officers.' And the next sentence is, 'Newly elected board members and (T. 63-65) [67] public officials quite frequently are greatly troubled by the fact that the institutions under their con-

(Narrative Testimony of Thompson Webb)

trol do not depreciate their plant assets as do all well-regulated commercial enterprises, and set about developing elaborate schedules of depreciation rates and directions for their application.' ”

Mr. Kumler: “Would it be of any help to your Honor if we offered that in evidence?”

The Court: “Just a minute; I may have a question. Or perhaps you can save me a little time. I am tempted to ask this question because of the expression that I attempted to emphasize: Does this bulletin or pamphlet undertake to point out in any further language a distinction between a public and a privately-owned school on the one hand, and a school which is conducted as a commercial enterprise?”

The Witness: “I think they do. I have read that with care several times. They recommend very strongly that the public institutions, the State-owned institutions and the eleemosynary institutions, carry their worth on their books always at the cost price, but they make the point on portions of property which they have, that are operated for commercial purposes, that they be depreciated. While they don't mention private schools as such, the inference is that, where you are operating commercially, you are required to depreciate, and I think your summary may give you that, which is a complete summary here of all the arguments that have been given.”

The Court: “Do I understand this might be left here at least as an exhibit for identification and then later it may be determined whether it shall go into the record in its entirety?”

Mr. Kumler: “If it will be helpful to the court, yes.”



(Narrative Testimony of Thompson Webb)

The Court: "Suppose you read the conclusion in its entirety."

The Witness: "The following principles applicable to educational institutions may be drawn from this discussion of depreciation:

"1. Educational institutions will find little or no benefit from the annual computation of, and accounting for, depreciation on their educational property.

"2. Depreciation should be accounted for on property used by the auxiliary enterprises and activities in order that the total cost of operating these activities may be known, and as an aid in determining rates of fees and other charges. (T. 65-67.) [68] If it is expected that this property will be replaced out of the income of the activities, it is essential that depreciation be accounted for.

"3. Institutions should account for depreciation on property held as the assets of endowment funds in order to maintain the principal of the funds.

"4. If depreciation is taken, it should be funded, that is, cash should be set aside in replacement, or depreciation funds.

"5. Three purposes may be served by the calculation of depreciation on educational plant, namely, determination of insurance values of property and equipment, determination of the true costs of instruction, and determination of the minimum amount that should be appropriated each year for replacement.

"6. Information on depreciation necessary for these three purposes should be recorded in subsidiary or supplementary records, and not as a part of the regular accounting procedure.' "

(Narrative Testimony of Thompson Webb)

The Court: "I have no other questions."

Q. By Mr. Kumler: "Mr. Webb,—"

Mr. Bryant: "Pardon me; I am going to move to strike all of the answers of the witness relating to depreciation on the ground they are immaterial to the present case. Depreciation was taken and has been taken at all times by this corporation. If we originally had a question of obsolescence and depreciation, that has been eliminated. I don't see the purpose of the present testimony."

Mr. Kumler: "Your Honor, it has been charged that the corporation had a large quantity of cash and securities around which it didn't need in its business. This authority to which Mr. Webb has referred here states that it is a justifiable business purpose to set aside in a replacement fund cash or investments, and that is what we want to show. If it is not germane to this issue, I don't see what is."

The Court: "It isn't clear to me just what is implied in the objection of government counsel."

Mr. Bryant: "I don't think depreciation has been taken by the parties in this case and there has been no argument in regard to it that I know of."

Mr. Kumler: "We were asking the question of financing replacement, how it should be done, and what is a reasonable way to do it."

The Court: "Let me see if we are talking about the same proposition. Are (T. 67-68) [69] you talking about the bookkeeping or are you talking about the setting up of any tangible form of the cash or the cash equivalent to provide against this depreciation?"

(Narrative Testimony of Thompson Webb)

Mr. Bryant: "I understood from the witness' testimony that he was speaking about their bookkeeping accounts. I may have misunderstood what he was trying to get at."

The Court: "As I understand that bulletin,—"

Mr. Bryant: "I haven't had an opportunity to inspect that bulletin."

The Court: "No; I don't think you did, and we want to be mindful, of course, of that. The bulletin will be marked as Plaintiff's Exhibit No. 3 for identification."

Mr. Bryant: "I understand that the purpose of the question is that the depreciation should be funded. Of course, with that understanding, the evidence would be material in this case and I would withdraw my objection based upon that."

The Court: "Yes."

Q. By Mr. Kumler: "Mr. Webb, I previously asked you to examine the facts set forth in Stipulations numbered 1, 2, and 3, which are in the record in this case. Have you done so?"

A. "Yes, sir."

Q. "Are you familiar with the balance sheets and profit and loss statements appearing in those stipulations and the other facts with respect to the plaintiff corporation?"

A. "I have read them a number of times."

Q. "Mr. Webb, assuming that, on August 31, 1939, the corporation, having the financial history set forth in the Stipulations 1, 2 and 3, was leasing its properties, including its name and goodwill, to a third party, who was actually conducting the school operation but whose lease would expire on August 31, 1942, and assuming,

(Narrative Testimony of Thompson Webb)

further, that the management of such a corporation, on August 31, 1939, was considering the possibility of not renewing that lease but of resuming complete conduct of the school business, and that the management of such a corporation had to have on hand sufficient working capital to resume the conduct of such business; and assume, further, that, as of August 31, 1939, it was a fact that the cost of replacing such corporation's main school building would exceed, by some \$150,000, the (T. 58-70) [70] original cost of such building; and assuming, further, it was a fact that such corporation needed to expend in excess of \$20,000 for extraordinary repairs and renewals at the expiration of the lease; and assuming, further, the shifts in population from which the school drew its students, as well as the limited amount of space available for the addition of facilities at the school, presented the management with the possibility of having to move the school, and that in such event the amount which could be realized from the sale of the land and buildings from its then location could not be expected to exceed \$75,000; assuming, further, that it is true that lending agencies do not consider school properties as good lending security; and assuming that the net earnings, after income taxes for the year ended August 31, 1939, were \$39,971.56, and that from such earnings dividends amounting to \$17,500 were paid to stockholders; assuming the facts to which I have referred to be true, have you an opinion, based on your knowledge and experience in the private school business, as to whether the excess of the earnings over the dividends paid, if accumulated by the corporation, would be within the reasonable needs of its business?"

A. "Yes; I have."

(Narrative Testimony of Thompson Webb)

Mr. Bryant: "I am not sure that I understand the question, if your Honor please."

The Court: "Would you like to have the reporter read it?"

Mr. Bryant: "Yes; I would."

The Court: "Or do you have it written out there so counsel can follow it?"

Mr. Kumler: "Yes; I do."

Q. "Have you an opinion, Mr. Webb, as to whether or not the excess of the earnings over the dividends paid would be within the reasonable needs of the business if accumulated by such a corporation?"

A. "Yes; I do."

Q. "What is your opinion?"

A. "I feel that it is very reasonable that they keep that to meet future needs. In fact, it seems to me imperative."

Q. "Mr. Webb, assuming all of the facts in the question which I just asked you were true, except the possibility of having to remove the school was so remote (T. 70-72) [71] as to be of little consequence, in your opinion, would that difference under the circumstances alter your previous opinion?"

A. "Not at all."

Q. "Now, Mr. Webb, I have another taxable year here. Assuming that, as of August 31, 1940, the corporation, having the financial history set forth in Stipulations Nos. 1, 2, and 3, was leasing its properties to a third party, including its name and goodwill, which third party was actually conducting the school business but whose lease would expire on August 31, 1942; and assuming, further, that the management of such a corporation, on August 31, 1940, was planning not to renew such



(Narrative Testimony of Thompson Webb)

lease but to resume complete conduct of the school business, and that the management of such a corporation had to have on hand sufficient working capital to resume the conduct of such business; and assume, further, that, as of August 31, 1940, it was a fact that the cost of replacing such corporation's main school buildings would exceed, by the sum of \$150,000, the original cost of such buildings; and assuming, further, that it was a fact that such corporation needed to expend in excess of \$20,000 in extraordinary repairs and renovations at the expiration of the lease in August, 1942; and, further, that it was true that shifts in population from which the school drew its students, as well as the limited amount of space available for the addition of facilities to the school, presented the management with the possibility of having to move the school at some future date, and that in such event the amount which could be realized from the sale of the land and the buildings at the then location could not reasonably be expected to exceed \$75,000; and assuming, further, that it was true that lending agencies did not consider school properties good security for loans; assume, further, that the net earnings, after income taxes for the year ended August 31, 1940, were \$22,829.13, and that from such earnings dividends, amounting to \$2500, were paid to the stockholders; assuming the facts to which I have referred to be true, have you an opinion, Mr. Webb, based on your knowledge and experience in the private school business, as to whether the excess of the earnings over the dividends paid, if accumulated by the corporation, would be within the reasonable needs of its business?"

A. "I have."

(Narrative Testimony of Thompson Webb)

Q. "What is your opinion?" (T. 72-73.) [72]

A. "I think it is very reasonable that they accumulate those assets to meet future needs."

Q. "Assuming, again, all of the facts in the second question I asked you are true except that the possibility of having to move the school might be so remote as to be of no consequence, in your opinion, would that condition under the circumstances alter your opinion?"

A. "No; I think it is very necessary to remain where they are before that accumulation. They would need it more if they had to move."

Cross-Examination—Thompson Webb

(At this point counsel for defendant reserved the right to move to strike the hypothetical questions, if the facts assumed in the questions were not established by the record, in the light of the fact that the witness was called out of order.)

Q. By Mr. Bryant: "Mr. Webb, did you study over this question prior to the time you heard it in court?"

A. "Yes Sir." (T. 74.)

"From my experience with a school of approximately 200 students supplying a normal high school instruction it is my opinion that the working capital requirements necessary for the average functions of such a school would vary tremendously. I have never studied it from a day school basis because mine is a boarding school. But I had to have about \$23,000 this summer for a boarding school, where the school provides board and room. That includes no clothing. The students buy their clothing in town.

(Narrative Testimony of Thompson Webb)

"The factors that go to make up a day school's operating capital include keeping the grounds in order; a number of skilled workmen painting and repairing." (T. 75.)

Q. "I don't think you understood my question. I mean as of the start of the school year. In this particular case, August 31st was the termination of the operator's lease. The school year would begin immediately thereafter; would it not?"

A. "Yes."

Q. "How much capital would you need to start, as of September 1st, for your new year operations?"

A. "I don't quite know how to answer that." (T. 76.) [73]

Q. "Have you had any experience along that line?"

A. "Well, our fiscal year ends August 31st and we start the new year September 1st."

Q. "Do you count against the operations of the new year the costs of the past fiscal year?"

A. "Well, no. You have to have a point where you divide, but your operations move steadily over that."

Q. "Suppose you had owned school properties, that you had leased those properties for a number of years to an operator who provided her own working capital, and, as of September 1st of a year, you would start operations of a school, she having operated under her lease up to August 31 of the year. How much working capital would you, in your opinion, need for this case of the school operation?"

A. "I would feel a lot safer if I had \$50,000."

(Narrative Testimony of Thompson Webb)

Q. "And for what purpose?"

A. "You don't know when you start this new management whether you are going to have a full school or not. You have to maintain your full staff and employ them in advance, and you may get tuition enough or may not."

Q. "I assume that you have a full enrollment."

A. "You would probably need \$25,000 if the enrollment was full."

Q. "And for what purposes?"

A. "To clean, paint and restore the place."

Q. "Have you examined the Marlborough School?"

A. "Yes."

Q. "How much would it cost to make summer renovations?"

A. "Probably eight or ten thousand dollars just to paint and clean and not to restore or get new furniture."

Q. "And that is the usual summer cleaning?"

A. "It would be with me and I think their plant is equivalent to mine."

Q. "Their buildings are the same as yours?"

Mr. Kumler: "I think, if your Honor please, the record is contrary to that. The record shows that there are two buildings at the plaintiff's school and some 20 buildings at the school of the witness. I wouldn't want a question to be based on (T. 76-77) [74] that assumption."

Mr. Bryant: "Your Honor, there seems to be quite a discrepancy between the two schools."

(Narrative Testimony of Thompson Webb)

The Witness: "They have two large buildings and they [we] have several small ones. There isn't a great deal of difference in the enrollment. They are a little larger than we are."

Q. "In facilities as well?"

A. "Possibly so. They are centered in a city block while we are scattered over a hillside."

Q. "Besides painting, what else would you have to spend money for?"

A. "Repairing, plumbing, school desks, chairs, rugs, and light fixtures."

Q. "How much do those things run you per year per item?"

A. "I don't know per item but we spend approximately \$10,000 a year in repairing our place."

Q. "Just over your full year?"

A. "Yes; and most of that is done in the summer."

Q. "That would be generally prior, then, to August 31st of each year?"

A. "Yes; part of it and part of it afterwards. We always try to get it before August 31st but they are still doing it now and the workmen promised to be through with it by September 1st." (T. 78.)

"I have read Stipulations 1 and 2. I have not read the lease attached to Stipulation No. 3. I didn't consider that as part of my answers to questions asked." (T. 78-79.)

"In answering the questions [hypothetical] I knew that the date on which the corporation was to commence operation of the school year was about two years later.



(Narrative Testimony of Thompson Webb)

"I don't know how much to allocate to earthquake insurance. I have never taken any.

"As an operator of a school I would carry a reserve in my surplus for the purpose of a reserve against fire losses not covered by insurance. I haven't carried any until recently, but it was reckless financing.

"Some schools by keeping to a budget can pay back loans but most of them have gone broke. I have kept within my budget. [75]

"All I know of the financial operations of the Marlborough School is what I have seen in the stipulations.

"I have known the Overton family over 15 or 20 years in the school business. (T. 80.)

"Except for my answer to the hypothetical question a school doesn't borrow money if it can get it some other way. That is true of most businesses."

The Court: "In view of that last answer, may I ask you, Mr. Webb, do you think or at least have you an opinion as to whether or not there is any greater risk on the part of a private school than an ordinary commercial enterprise in undertaking to finance their loans?"

The Witness: "Well, I think it is because the record shows that the greatest casualties in any type of business in the world are in private schools. That is why your loan companies don't want to lend them any money."

The Court: "I have no further questions."

Mr. Kumler: "That is all, Mr. Webb." [76]

\* \* \* \* \*

HUGH L. MANN,

a witness for plaintiff, being duly sworn, testified as follows:

Direct Examination—Hugh L. Mann

"My profession is real estate broker and real estate investments. I have been engaged in the real estate business since 1916; since 1921 in Los Angeles. I specialize in income property; some homes. From 1923 to 1927 I was sales manager for the W. M. Garland Company. Since then I have had my own business. (T. 82.)

"I have had experience with special purpose properties such as country clubs and private schools; specialty buildings would include theatre buildings.

"In 1937 I made a deal on the Brentwood Country Club and sold their entire holdings. Shortly after the sale I had charge of the property with the idea of making two private schools there, one out of the old club house, which at that time was under lease as a private school, and one out of the new club house. I went to a great deal of effort trying to sell those two improved properties out as private schools. (T. 83.)

"I didn't have any success trying to sell the property for school purposes. Eventually we tore the old club building down and sold off the lease.

"Generally speaking there is no ready market for the specialty properties to which I have referred. It is almost impossible to sell school properties. The reason is that it is a very hazardous business. In advertising extensively I had a few answers to the ads. Those people who answered I interviewed. They were invariably someone with school experience but no money. (T. 84.)

"I tried to sell the Collegiate School for Girls, down at Glendora, for the Citizens National Bank after they fore-

(Narrative Testimony of Hugh L. Mann)

closed on it. I did not succeed. I couldn't find anyone with any money to handle the deal.

"In my experience as a real estate broker, I know that the Harvard School which was foreclosed by the Pacific Mutual Life Insurance Company, has been on the market for many, many years.

"As an underestimate I would say I have sold 300 or 400 pieces of property in Los Angeles since 1921. (T. 85.) [77]

"I have personally examined the land and buildings at Marlborough School at the corner of Third and Rossmore. (T. 85.) I have an opinion as to the fair market value of the land and buildings of the Marlborough School as of August 31, 1939, in the light of then existing conditions. In advance of giving an opinion may I explain that due to the restrictions I have got a determining factor there. The land is actually the principal value. The total fair market value of the land and buildings is \$67,865. (T. 86.)

"I am familiar with the deed restrictions. They expire in 1950. I took that into account in reaching my valuation.

"I would say that as of August 31, 1940 the situation had not changed materially with respect to the fair market value of the same property.

#### Cross-Examination—Hugh L. Mann

"I found a value of \$67,865 for 1939, and the same figure for 1940. I didn't assume a purchaser ready, willing (T. 87) and able to buy; it would be a question of trying to find one. I used sales of property more in character as a basis for these valuations. I told you

(Narrative Testimony of Hugh L. Mann)

that I had not sold any schools. I simply made the efforts and lots of them. I heard the gentleman on the stand here state that Harvard or the Pacific Mutual, rather had finally sold their plot of ground which I know has been on the market for about 10 years or more.

"The entire area adjacent to Marlborough School is R-1 zone. The particular plot that Marlborough is on, I understand it, falls in a special zone. There is R-1, -2 and -3, but I don't think anything fits there except R-1. (T. 88.)

"I didn't investigate with the Planning Commission to determine the zone, or whether there had been any variances or exceptions. I just know that the deed restrictions expire in 1950. I did not investigate that with the Planning Commission. I live so near the school, and have for 20 years, that I happen to know from common knowledge the situation that exists there. I know about a zoning ordinance that permits the school at that particular plot. Of course the buildings are 30 years old and I have had some experience myself that at any time you start to rehabilitate an old building where a building ordinance is passed they prohibit the rebuilding of them unless they are fireproof. It would be either very expensive or impossible. (T. 89.) [78]

Q. "Did you check any of the variances granted in relation to construction during the years 1927 and 1931?

A. "No; I haven't.

Q. "Do you know whether any were granted?

A. "Only through hearsay.

Q. "You made no investigation as to that?

A. "No.

(Narrative Testimony of Hugh L. Mann)

Q. "You made no investigation then, I judge, as to what the factors involving that school are except for common knowledge in the vicinity?"

A. "Yes.

Q. "And your opinion is based upon those figures?"

A. "And the surrounding values providing the property had to be sold back into residential properties.

Q. "And your estimate is based upon the fact that the school property would have to be sold back to R-1 use?"

A. "Do you mean rezoned?"

Q. "No; not rezoned but re-used under the provision of R-1 zones.

A. "If it should be continued or—do you mean past 1950 as a school?"

Q. "Have you examined the deed provisions that expire in 1950?"

A. "I haven't read it; no.

Q. "Have you examined the ordinances in relation to the particular plot?"

A. "No.

Q. "You don't know, then, what restrictions there are against or favoring the particular property?"

A. "As I understand, the original deed restrictions from Mr. G. Allen Hancock permitted use of the private school there until 1950, at which time it will no doubt all come up and nobody knows then what is going to happen.

Q. "Then, it is your opinion that the school will no longer be able to operate in 1950?"

A. "They possibly might.



(Narrative Testimony of Hugh L. Mann)

Q. "They would have to get permission from the Zoning Commission?

A. "Yes; plus the Building Department, which possibly would call for the rebuilding of the buildings there to make them fireproof.

Q. "Are you familiar with the laws and regulations regarding zoning ordinances?

A. "Zoning ordinances?

Q. "Yes.

A. "Somewhat.

Q. "Are you familiar with the laws regarding non-conforming uses? (T. 90-91.) [79]

A. "I have had some falls on non-conformed buildings and, when you start to spend some money on them, you get into a lot of grief.

Q. "Have you made any investigation or do you know anything about the law regarding the use of non-conforming buildings?

A. "Any time that you start remodeling one of them past a certain per cent of its original cost or duplication cost, you have to go back to the existing laws at the present time.

Q. "Is there any possibility of gaining a variance or change here?

A. "I imagine that would fall within the discretion of Mr. Suess.

Q. "And who is Mr. Suess?

A. "He is the man that runs the Planning Commission.

Q. "Is he the zoning commissioner of the City of Los Angeles?

A. "He is everything.

(Narrative Testimony of Hugh L. Mann)

The Court: "What is his official title?"

The Witness: "I believe he runs the Planning Commission, better known as a dictator.

The Court: "For the purpose of the record, will you tell us whether or not he is on the payroll of the city and, if so, in what capacity?"

The Witness: "Yes, he is the head of the Planning Commission.

The Court: "In other words, he is Chairman of the Planning Commission of Los Angeles?"

The Witness: "I suppose that would be his title.

Q. By Mr. Bryant: "Do you know in what zone private schools, except trade, music or physical culture schools, may exist in the city of Los Angeles?"

A. "R-2 and -3, I believe.

Q. "Did you use all of these factors in coming to an opinion as to the fair market value of the premises?"

A. "I did.

Q. "Did you consider the length of time in which the present property could be used?"

A. "I did.

Q. "How much longer, dating from August 31, 1940, do you feel that the (T. 91-93) [80] school could be used in its present location?"

A. "As long as there are buildings existing, I figured it would run until 1950.

Q. "And the reason they couldn't be used beyond 1950 was the deed restriction?"

A. "The deed restriction or else the revamping of the buildings to meet existing fire ordinances or building ordinances.

(Narrative Testimony of Hugh L. Mann)

Q. "In other words, you feel, basing your opinion as to the value of the property, that it would be necessary to revamp or reconstruct the buildings?

A. "I know that the Building Department, any time that you start trying to remodel an obsolete building, especially where you are housing people, which will hold true in theatre or church or any place where there is a volume of people collected under one roof, want you to come back and erect fireproof, non-hazardous buildings.

Q. "Did you consider those factors in coming to your opinion?

A. "I did.

Q. "In the value that you have placed upon the premises?

A. "Yes.

Q. "If I told you that there were no deed restrictions compelling the abandonment of the school in 1950, would your opinion as to the value of the school be changed?

A. "I know a permit will have to be had from the Planning Commission.

Q. "Answer my question, please. Mr. Reporter, will you read the question, please?

(Question read by reporter.)

A. "I don't think that exists, that condition.

The Court: "Let's see if we understand your testimony. Assume that the present buildings did not have to be removed because of any deed restriction in 1950, would your answer as to valuation be the same as you have already given?

The Witness: "Yes; it would, because those buildings are 30 years old now and, in 1950, they will be 40 years old, and they are certainly likely to be put in the class

(Narrative Testimony of Hugh L. Mann)

of a firetrap because they are just frame except the auditorium (T. 93-94), [81] of course.

The Court: "When you speak of the buildings being 40 years old, you are referring to the structures built in 1916?

The Witness: "Yes.

The Court: "And not to the auditorium?

The Witness: "No.

The Court: "Which was built some 18 years ago?

The Witness: "Yes. Of course, it is a much better building. The original building was quite an old building.

Q. By Mr. Bryant: "Assuming, Mr. Mann, that the school location and buildings now used have a less or a more restricted use, would that change your estimate as to the value of those buildings?

A. "More restricted?

Q. "Yes; that is to say, assuming that the school at present is located in an R-3 residential zone, that is, the zone law applicable to buildings; assuming that it could be used for an equivalent use or a less restricted use, such as an apartment house or boarding house, with not more than 12 rooms for rent, a boarding school, a bungalow court, a church, except temporary revival, a college, a convent, a dormitory, a multiple dwelling, an educational institution, public or quasi-public, a fraternity house, a public library, a lodging house, a museum, a non-philanthropic nursery school, a parish house, a rooming house with not more than 12 rooms, a 4-family flat, a triplex, a double dwelling house, a duplex dwelling house, or for a park, would your opinion as to the value be changed if it were usable for those things?

A. "If any one of these types could be built on it?

(Narrative Testimony of Hugh L. Mann)

Q. "Yes.

A. "It certainly would. It would materially affect the value of the property.

Q. "And, if the present buildings or the ground could be used for those purposes, if the ground or the present buildings could be used for any of those purposes, would your opinion as to the value of the buildings be changed? (T. 94-95.) [82]

A. "Yes.

Q. "Under those circumstances, suppose that it was usable as a boarding school or a boarding house, what would be your opinion as to the value?

A. "You couldn't get a firm to open it up as a rooming house, if that were possible, for the reasons I have enumerated heretofore.

Q. "Supposing you could? Supposing you are wrong?

A. "Well, I know it can't be done. If I may state, down on Arden and Lucerne the restrictions expired many years ago, and some groups here in town purchased that property with the idea of erecting apartments and it was thrown back to R-1 and there it is today. And they paid fancy prices for property that is frozen for a long time to come. There are too many millions of dollars of fine homes in all directions for that to happen out there.

Q. "You live right there, do you not?

A. "I do and I happen to know what the existing conditions are.

Q. "Where do you live?

A. "I live at Fourth and Irving Boulevard.

Q. "How far is that from this property?

A. "About six blocks and a half.



(Narrative Testimony of Hugh L. Mann)

Q. "And, if I told you now that it could be used, the Marlborough School, as it is now constituted, that it could be used for a church—

Mr. Kumler: "Do you mean legally, Mr. Bryant?

Mr. Bryant: "Legally.

The Witness: "I wouldn't believe it.

The Court: "You are not being asked as to what may legally be done with the subject property. You have already told us on direct examination your opinion as to the market value of the subject property as of certain dates and in arriving at that opinion you have assumed certain facts and conditions to exist. Now, on cross-examination, you are being asked to assume, not to tell us what the legal status of the property is, but to assume certain other facts, and I think you should direct your answers to the questions thus presented.

The Witness: "Maybe I don't quite understand.

The Court: "Suppose you reframe your question. (T. 95-98.) [83]

Q. By Mr. Bryant: "You have sold other types of buildings besides school buildings, have you not?

A. "Oh, yes.

Q. "And attempted to sell them?

A. "Yes.

Q. "Now, directing your attention to the dates of August 31, 1940, and August 31, 1939, would your answers as to value as to that location be substantially the same as to each year?

A. "Yes.

Q. "Now, assuming that the Marlborough School as it is now constituted could be employed for other purposes besides a school, for the purposes which I have named,

(Narrative Testimony of Hugh L. Mann)

under the law, would your opinion as to the value of the premises be changed?

A. "Sure. I said that a while ago.

Q. "Under those conditions, what would you value the premises for if it were usable as an apartment house?

A. "If you are building apartment houses, residential income—

Q. "No; pardon me; not apartment houses.

A. "On anything that will produce income, it would be worth a great deal more money than in an R-1 zone, R-1, -2 or -3.

Q. "Are you familiar with the types of buildings that are classified within an R-3 zone?

A. "This list that you just enumerated comes within one of those zones, does it not?

Q. "I will show you a document which is prepared by the City of Los Angeles. Mr. Kumler and I have both examined this. Assuming that the present buildings could be used for any purposes within the same class of restrictions or a less restricted use, would your opinion as to value be changed?

The Court: "May I suggest that the question leaves the record somewhat incomplete? You haven't indicated the nature of the document you are showing to the witness. What is that you are showing him?

Mr. Bryant: "It is a list of uses permitted under various zones. My (T. 98-99) [84] opinion is that it has no official standing except as an indication by the Zoning Administrator under his regulations. It is Case No. 121, enacted on November 21, 1941, or a decision rendered on that date, listing the uses permitted in the various zones so that the public may be advised in a con-

(Narrative Testimony of Hugh L. Mann)

cise manner as to the purpose or uses allowed within the restricted zones according to the classifications established.

The Court: "Does the memorandum give the types under each particular zone classification?"

Mr. Bryant: "Yes, your Honor.

The Court: "And under what classification were you reading when you propounded the previous question as to the list of various types of uses?"

Mr. Bryant: "R-3, R-2 and R-1. Class A would be the equivalent of R-1.

The Court: "Will you read the statement of counsel? (Statement read by reporter.)

The Court: "I don't think I understand that answer. Is an R-1 the single family residential zone?"

Mr. Bryant: "The uses that are listed in this item may be maintained in an R-1 zone.

The Court: "I don't understand the use of the expression "Class A." What has that to do with zone R-1?"

Mr. Bryant: "It is not pertinent to this issue. However, there are several Class A zones still left in the city of Los Angeles which have not been classified into R-1, and the reason I used it was the document itself has the "A" designation. If I may see it, perhaps I could explain it to you. It says "R-1," or "A," "Residential Zoning."

The Court: "Will you clear up for me the theory upon which the witness is asked to assume that the subject property may be used for a number of purposes other than those defined under "A-1" or "A, Residential Zoning," and those defined as exempting the ordinance covering the subject property?"

Mr. Bryant: "Your Honor, any non-conforming use may be continued to a less restricted use without request

(Narrative Testimony of Hugh L. Mann)

of a certain variance or any zoning change. (T. 99-101.) [85] An equally restricted use, in other words, use within R-3, may be petitioned for from the Zoning Administrator, who may grant the same without hearing. He grants that upon a showing that the use, the non-conforming use, would be no more obnoxious in its location than the present non-conforming use.

Mr. Kumler: "Mr. Bryant, do you mean the use of the present buildings there?"

Mr. Bryant: "Yes."

Mr. Kumler: "Otherwise, we want to object to the question."

Mr. Bryant: "I will have another question to ask concerning that, covering the buildings."

The Court: "Let me see if I follow counsel. Is this your position, that, under the zoning ordinances of the City of Los Angeles, as of August, 1939, and August, 1940, respectively, a school, musical or classical, a dancing and a trade school, and various other types of properties, could be built in what is defined as C-2, Commercial Zone, and the witness is asked to assume that the subject property, with the present buildings, might be used for any one of the types of improvement which are listed in the category of Zone C-2?"

Mr. Bryant: "No; R-3, your Honor."

The Court: "In other words, the position of government counsel is, in substance, then, that, as of the period or periods in question, the type of school such as that involved in the present lawsuit could be built within what is known as Zone R-3?"

Mr. Bryant: "No, your Honor. That school could be built—yes; that is right."

(Narrative Testimony of Hugh L. Mann)

The Court: "And that, likewise, in that same zone other structures might be built, such as a bungalow court, a library, a lodging house, a rooming house with not more than 12 rooms for rent, and an apartment house? Does that mean having a four-story height limit?"

Mr. Bryant: "No, your Honor. They would have to use the same buildings as they have there now."

The Court: "Will the reporter read my last statement to counsel, I mean beginning with what counsel's position is? (T. 101-102.) [86]"

(Record read by reporter.)

The Court: "Are you asking the witness to assume that, under the zoning ordinances of the City of Los Angeles, the existing improvements might lawfully be employed for such purposes or businesses as an apartment house, a lodging house, a church, excepting a temporary revival, a bungalow court? Would that circumstance affect his opinion as to the value of the subject property as of August, 1939, or August, 1940? Is that the question?"

Mr. Bryant: "That is the question, your Honor; yes."

Mr. Kumler: "If that is the question, your Honor, we must object on the ground that there is not a legal basis for that assumption unless you add to the question the fact that the approval of the director or the zoning administrator be obtained first. If that fact is added to it, then we will withdraw our objection."

The Court: "Will you assume that you have been asked the question that I have last stated, plus the further assumption that a permit can be obtained from the city zoning authorities to use the subject property for one or another of these other uses?"



(Narrative Testimony of Hugh L. Mann)

The Witness: "Does that go back to that hypothetical question a while back? Under the ramifications over at the City Hall, that is a great assumption.

The Court: "You are going to be asked to leave the legal questions alone and whether or not the permit can be obtained is to be eliminated from your thinking, and you are asked to assume an entirely different set of facts. In other words, you are being asked a different hypothetical question, namely, assuming that the existing buildings, as of August, 1939, and as of August, 1940, would be used, as a matter of law, for one or another of these other purposes, would that change your opinion as to the value of the subject property.

The Witness: "It would not change the value, in my opinion. Now, may I explain?

The Court: "Certainly.

The Witness: "When you get into one of these—we call them in the real estate world—white elephants, a building that is built for a special purpose, and you try to revamp it into something for some need, then it falls (T. 102-104) [87] back into this non-conformity building and you had just as well tear them down to the ground and start off with a new building because, by the time—well, I am saying things I shouldn't, I guess. But by the time you get through over at the City Hall, you have to revamp your building, that is, if you get the permit, you have got to revamp that building. I know because I have done it myself and I know what the ramifications are over there. You had just as well tear it down to the foundation. If you get your permit, that is what you will do. I will tell you that.

(Narrative Testimony of Hugh L. Mann)

Q. By Mr. Bryant: "Assuming that you do not have to revamp the building, then what is your opinion as to the value?"

The Court: "Let's see if we understand one another. Does that question mean assuming that, for legal purposes, the building need not be revamped or, for practical use, it need not be revamped?"

Mr. Bryant: "I am assuming for the use contemplated, to use the buildings just as they are or were."

The Witness: "You have got one purpose then for the buildings as is and that is a private school."

Q. By Mr. Bryant: "And you can think of no other purpose?"

A. "Without revamping?"

Q. "For a school."

A. "You have got to revamp them and, when you do that, you get into trouble unless you build new buildings. (T. 104-105.)"

"I figured the value of 562 feet of unimproved ground on which the school was located at \$39,340, on August 31, 1939. It has a frontage on Rossmore starting 150 feet north of Third Street. I figured 562 feet on Rossmore. The basis of that figure is \$70 a front foot which is liberal. I sold 115 feet backing up to the Country Club at the same time for \$8,000. The corner [150 feet on Rossmore at the corner of Third Street], was \$10,000. The restrictions on the other three corners run until 1970. Somebody has already paid more taxes out than they are worth today. My valuation (T. 105) [88] of the Marlborough property fronting on Third Street was \$10,000. (T. 105.) That is an R-1 zone. That is \$66 per front foot. I figured the frontage [of the corner] on Ross-

(Narrative Testimony of Hugh L. Mann)

more is 150 feet. The Third Street frontage is much worse on account of the traffic.

"I have not recently sold any property on Third Street. One property was sold there last week, right east of there, that had been on the market three years. They sold it to a lady that couldn't hear the noise. That property was a corner piece at Third Street and Plymouth. I think the northwest corner.

"I formed an opinion of the salvage value of the present buildings if the school should no longer use them. Very little could be expected to be had out of them. (T. 106.) It might cost money to get them torn down. As of August 31, 1939, I would say \$5,000.

(The \$5,000 figure was a misprint as the witness later testified that the salvage value was \$15,000 which with other values accounts for his total value of \$67,865.)

"My answer for 1940 would be the same.

Q. "In determining the market value of the land and the school buildings as of August 31, 1939, and as of August 31, 1940, if those buildings were used or usable in their present condition for the uses set forth in Zones R-1 and R-2 and R-1-5, that is to say, for four-family flats, triplex dwelling houses, courts, or parks, or something similar, what would you place the market value of that land and improvements?

The Witness: "In other words, you want me to say what the value of that land would be in 1950 if all these things could be done?

Q. By Mr. Bryant: "In 1940.

A. "Well, we know it is a physical impossibility for it to happen before 1950, don't we, due to the deed restrictions?

(Narrative Testimony of Hugh L. Mann)

Te Court: "Have you given that item consideration, Mr. Bryant?

Mr. Bryant: "Yes, your Honor. The deed restrictions did not require that the school be terminated at the location.

The Court: "Do the deed restrictions permit the other uses in 1939 and 1940? (T. 108-109.) [89]

Mr. Bryant: "No, your Honor; I don't believe they would.

Mr. Kumler: "The stipulation, I think, shows that they would not permit such use at least until 1950.

Mr. Bryant: "Single family residence except for school purposes—"

Mr. Kumler: "Except for particular school purposes," but that restriction expires in 1950. But our valuation is as of 1939 and 1940.

The Court: "I think it would be clearer, then, if you would rephrase your question so as to indicate that, on the one hand, up to 1950, the subject property could not be used for any such other purposes but that, at the beginning of 1950, the witness is asked to assume that the subject property could be used for one or another of those other purposes. Is that clear to you?

A. "That is clear.

Mr. Bryant: "I think I will rest on your Honor's statement of the question, if I may.

Q. "Then, what would be your opinion as to value?

A. "I cannot tell you and any human being in all Kingdom Come cannot tell you because Los Angeles grows and lots of things happen around there, and, to predict what anything is worth 10 years from now, is foolish.

(Narrative Testimony of Hugh L. Mann)

The Court: "Perhaps you didn't understand the question. You were asked to assume you were called say before the board of directors of the Marlborough Corporation in August of 1939 and you were shown the deed restrictions and you were shown the provisions of the zoning ordinances relating to Zones R-1—is that it?

Mr. Bryant: "1 to 5 and R-2 and R-3.

The Court: "And you were asked to appraise the market value of the subject property. In your opinion would you be able to give an opinion to the board of directors at that time?

The Witness: "I would give it the same value as I did a while ago, based on the R-1 residential purposes, and that is the only thing you can do.

Q. By Mr. Bryant: "How did you come to the value of \$67,865?

A. "We didn't figure that up there a while ago. There are 47 feet around there on Third Street that I gave \$3,525 to and 552 feet on Rossmore (T. 109-111) [90] as \$39,340. And I gave \$15,000 to the buildings based on that 10-year period.

Q. "\$15,000?

A. "Yes.

Mr. Bryant: "I think that is all the questions I have. (T. 111.)

Redirect Examination—Hugh L. Mann, by Mr. Kumler

"From my examination of the buildings on the site at the present time they are not suitable for uses for the purposes which counsel [defendant's] as been discussing such as a four-family flat, triplex and so on, without substantial alteration.



(Narrative Testimony of Hugh L. Mann)

“In the event the present buildings are removed from the land or so substantially altered as to cause it to revert to R-1 status my opinion, originally as given would depend on conditions existing in 1950. I wouldn’t alter the value as of 1939 and 1940. (T. 111.) I didn’t attach any consideration to possible uses which could be made in the future say 10 years hence, assuming the zoning ordinances were different because I happen to know the ramifications. I didn’t give that consideration because I know it is impossible. (T. 112.) [91]

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Testimony of C. G. Brown.

C. G. BROWN,

a witness for the defendant testified as follows:

Direct Examination—C. G. Brown

“I prepared defendant’s Exhibits A and B. The facts stated therein are true to my best knowledge and belief. The appraisals made therein are to the best of my ability in the length of time I had to do it. It is not a finished appraisal in the sense that I wanted. To get down to physical work, if I made a regular appraisal it would take 10 days or two weeks time. I don’t think it will [would] vary in amount. (T. 117.)

Cross-Examination—C. G. Brown

Q. “How much time did you take on it, Mr. Brown?

A. “I started, I think Monday and I was in court here—I wanted to hear the testimony of Mr. Austin. I dropped everything else. I have been working on figures. In figuring out, this is quite a bit of calculation to be

(Narrative Testimony of C. G. Brown)

done to get the areas correct, before you start on the question of values. What I mean is it is not a sand-papere<sup>d</sup> parcel dolled up and down to where all the supporting evidence is there. We appraisers have a very definite idea as to the value of a piece of property and then we like to verify it because in that way we keep up-to-date. If we go on our own judgment too long, the first thing we find out is that we go off on a tangent somewhere. So we like to go through the motions of verifying our conclusions on each appraisal. (T. 118.)

"I had an opportunity, in a sense, to verify these figures in the usual manner. I checked with real estate men but this only confirmed my opinions as far as costs were concerned. I am working with these things all the time and I didn't figure it was necessary to verify those, although I put in an hour talking to a builder, Harry Wright, and a half an hour over at the Building Department where we talked unit values.

"The five types of estimates on appraisals shown in defendant's Exhibit B were, you might say, 90 per cent verified at the time I made them because I made them from experience. I am familiar with the district as to land values, and I am familiar with building costs. I was just fixing a soft place to light on because when you answer a number of complicated, involved (T. 118-20) [92] questions like that in a hurry, you might slip up as to some small detail. If you had more time you would not be in error. But I will say that roughly or essentially they are correct and they were verified from past experience. Then I did check with two persons, one of whom is or should be very well qualified. He is with the Building Department. They have to calculate the cost of

(Narrative Testimony of C. G. Brown)

buildings when they assess for items over there. Mr. Wright was a little modest. He has put up millions of dollars worth of buildings but when it came to Class A school buildings he seemed to think I knew more about it than he did. That is Harry Wright, of Harry Wright Construction Company. (T. 118-120.)

"I checked my temporary conclusions as to the market value of land and buildings "as is," in item 5 of defendant's Exhibit B, by talking with Glover, who was formerly an appraiser and is now a salesman with Coldwell Banker. I have considerable confidence in him. I also talked with Mr. Detoy, firm manager of the Wilshire offices. I have appraised some schools, even the Hollywood School for Girls; also the Paige Military Academy, the latter on a condemnation suit and I went into that quite thoroughly. I checked over other schools in town to see what I could find out, to help me make my appraisal of that. That was a property of approximately the same value. I testified, I think, it was worth \$35,000 and I don't think the following six appraisers varied in any material amount from that. That was on San Vicente Boulevard. I assumed its continued use as a school or the highest and best use, which ever you can use it for. That factor must be in the market value.

"I found no records of sales of school property, but did find some negotiations. I didn't have time to get the records. I make appraisals where I go look up a bunch of deeds showing the grantor and grantee and when it was recorded and either myself or I have a man do what we call field work. We find out if it was a sale in the open market and why he wanted to sell and why he wanted to buy and use one sheet of paper for each sale

(Narrative Testimony of C. G. Brown)

and make a record of that. This I didn't have time to do at all. There have been some school sales here. I believe the Harvard Military Academy moved. The Government took it over on a lease. Harvard is in the same fix as the others. (T. 121.) Perhaps they want to get a little further west and need more ground. I didn't examine the Harvard sale with respect to this situation but I did when I appraised the Paige (T. 122) [93] Military Academy. The appraisal of Paige was based primarily on going concern value with land and depreciated value of the buildings. We did give a great deal of weight to the cost of reproduction. (T. 122.)

"In arriving at my appraisal here [Defendant's Exhibit B] I didn't use the same plan as in the Paige appraisal. I knew the cost of reproduction less depreciation. And will say this, that, to find out the market value of that property if the present owner were to give it up and place it on the market—and I assume without any restriction against it being used for school purposes—it would be worth practically nothing. It might not be used for school purposes, but that is just a sort of percolated distillation of my judgment on the thing. The number of purchasers for school purposes is limited, but there is a fine property there. It was designed by an architect that knew his business and the whole thing is a beautiful place for a school to come in if they can get it at a price. I put on these a price at cost less reproduction, less depreciation. There is only one Los Angeles and it is bound to grow (T. 121-122) and a school catering to a class of people like this, they would be glad to get that at a price and this price here is less than half the cost of reproduction, less depreciation and I

## (Narrative Testimony of C. G. Brown)

think that would be getting a bargain if they wanted a school. Glover told me he had one school looking for a location at this time. He said they were looking for a plant at \$175,000 and another at \$200,000. I do not know what ones they were looking at and did not ask because I thought he might want to keep that to himself. A religious organization, and I believe that might fit in with a school, can use things like that for training students. Take the Rindge Castle out here. The average appraiser would call it an example of a house in the desert. There was a castle out there on a hillside with nothing else around it. But a Catholic organization bought it for a retreat and they can use it very nicely. As I say, there is only one Los Angeles and it is bound to grow. I try to keep up-to-date and figure out trends, but every once in a while I see something in the paper where somebody has done something that has slipped by me that I hadn't foreseen at all. I wouldn't be a bit surprised, if that school were put on the market and a good salesman like Glover went to work on it he probably could (T. 122-124) [94] turn up three or four schools. Whether or not they would have the money or it would suit them I couldn't say, but I know if I owned it, I would not think for a minute, if I didn't move it, of scrapping it. In fact, it is a possibility they might use two plants within the present one. But I am not an authority on the school business in that way. (T. 122-124.)

Q. "I think it is just as you have stated, a possibility rather remote. Let's leave that out of consideration for the moment. You stated a minute ago that your market value was determined, at least in part, by reconstruction, less depreciation, did you?



(Narrative Testimony of C. G. Brown)

A. "I said I knew what the reproduction cost depreciated was at the time I made an estimate of the market value. Yes; I considered it.

Q. "When you consider reconstruction cost, is that construction under the building codes or in the form the main building now exists?

A. "The way it existed in 1939 and 1940.

Q. "Are you aware that the deed restrictions on that property run until 1950?

A. "Yes and no. It is hearsay with me but I understand that there are other restrictions in there until 1970. I know it in this way, that the deed restrictions are such as to stop much speculation. If people buy a lot in there, they buy it because they want to build a house. That isn't property down on Wilshire Boulevard, where some of the same restrictions are in force. They will buy it down there without knowing why they want it and they will buy it for the purpose of—

Q. "To save time, let us confine ourselves to this locality. I think you stated you were familiar with the fact that the adjacent properties were subject to deed restrictions until 1970. Are you familiar with that fact?

A. "That is my understanding; yes, I have at different times gone into those deed restrictions thoroughly but I didn't take time to verify them on this. I just assumed that that was it because it is general hearsay out there, I believe, that some of them are 1950 and some of them 1970. But the important thing for my purpose is the deed restrictions were in effect to the extent that nobody is going to buy it as a speculation or for any other use than residential. (T. 124-125.) [95]

(Narrative Testimony of C. G. Brown)

O. "In other words, your valuation is arrived at on the assumption that those restrictions are in effect and will continue in effect until 1950 and 1970, respectively?

A. "That is true, except that I very much am aware of the fact that they had zone variance, or whatever it is, there that allowed them to erect these school buildings; and, in case the buildings were up before it was zoned, I figured the buildings could stay there as long as they were so used. That was the situation that arose as far as the zoning restrictions are concerned with respect to the auditorium building at the time it was erected. I mean—

Q. "Now, Mr. Brown, what uses, in arriving at your figures of fair market value here in 1939 and 1940, if any, other than R-1 uses or use as a school building, did you assume this property had?

A. "I assumed it had use only for school purposes or it would have to be something so nearly similar and like school purposes. It would have to be a quasi-school. You couldn't use it for a sanitarium or a hospital or those people would get up in arms there.

Q. "What particular uses did you consider within the category of similar uses?

A. "None such occurred to me. I figured it only as to a school. If I were trying to sell it, I would try to sell it only to somebody who could use it for school purposes.

Q. Do you happen to know whether or not the property on which the Harvard School at 16th and Western,

(Narrative Testimony of C. G. Brown)

or Venice and Western, is situated, is zoned for commercial uses there?

A. "No; but I would be willing to wager a hundred to one that it is at least part on Western Avenue and Venice, too. I have a zoning book and, when I want to know the zone, I simply refer to that and don't try to carry them in my head.

The Court: "May I ask counsel in propounding the last question were you undertaking to call the witness' attention to the fact that the so-called Harvard School, at Western and Venice, eventually was sold at a time when the property was zoned for commercial use? (T. 125-127.) [96]

Mr. Kumler: "That is what I was asking the question for.

The Court: "Did you have that factor in mind when you were undertaking to appraise the subject property?

The Witness: "I think I should say yes. But I paid very little attention, your Honor, to the Harvard School. I just knew that was sold; that the character of the neighborhood had changed and it wasn't used for school purposes any more. And you might say I bore down a little bit in my mind in putting this price on there.

The Court: "Are counsel able to agree on the size of the Harvard School site at Western and Venice Boulevard?

Mr. Bryant: "I am not familiar with the Harvard School, your Honor. I made no investigation with respect to it. It is an entirely different type of school. It is a different type of neighborhood and a different age and different size of ground, I presume. Someone testified it was 700 by 700 if I remember the testimony correctly,

(Narrative Testimony of C. G. Brown)

but I don't see that that is really material except in testing the amount of consideration this witness has given to that. He states that he has given it only slight consideration. And, inasmuch as that sale must have taken effect quite a few years after the taxable years in question, concerning which the witness has testified, I don't see that it is material.

The Witness: "Off the record, I will correct one dimension. While I don't know the exact dimensions, I know it is not 700 by 700. It might be six or seven hundred on Western and it goes one block the other way.

Mr. Bryant: "As I state, I am not familiar with the size excepting the testimony here.

The Court: "Let me add this observation. The thought that prompted my interruption was that yesterday Mr. Morgan Adams, and I am not sure but what also the witness Mr. Mann, called attention to the so-called Harvard School site and the difficulty in disposing of it; that eventually, after it had been foreclosed by the Pacific Mutual Life Insurance Company, the property was sold at quite a substantial loss at a time when the property was rezoned for commercial use. Assuming those facts to be true, I think the Harvard School site (T. 127-128) [97] the witness said was sold for \$150,000 but here, on Exhibit B, I believe the witness has appraised the site of the subject property at \$60,000. Taking into consideration the restrictions that still exist, I am interested in this phase of the cross-examination. It doesn't at least sound convincing to me how the witness arrived at this figure of \$60,250.

Mr. Bryant: "If counsel and I may enter into a stipulation here for the purpose of the record, it may be

(Narrative Testimony of C. G. Brown)

of interest to your Honor. The 1939-40 assessed value of the real estate is \$35,610 and the improvements \$33,220. I am reading from the tax bill, 1939, to the Marlborough School. There is an additional piece of property, unimproved, valued at \$1,700. The two combined would be assessed valuation according to the County Tax Collector's records. Will you stipulate to that?

Mr. Kumler: "I will stipulate the tax bills show that.

The Court: "Of course, in eminent domain proceedings, we are quite aware of the fact that assessment valuations may not be relied upon either as a matter of law or shall we say common sense, and experience indicates how unwise it would be to do so.

Mr. Bryant: "We merely present it for whatever weight it may carry as to the value of the property. The usual assessment practice is to assess on a 10-year basis and the general average market value or the percentage of the market value, I should say, judged on a 10-year basis. The policy of the assessor's office is to arrive at as approximately a correct assessment as they can of the assessed valuation. In the event they are too high, it has been quite common practice for taxpayers to appear before the County Board of Supervisors, sitting as a board of equalization, for the purpose of reduction of such taxes, and the prices arrived at through the years should come to some figure which is fairly close to the market value of the property.

Mr. Kumler: "I think your Honor might also notice that the assessed values put on certain types of properties, especially properties like expensive homes and residences, almost invariably exceed what they are sold for when they are put on the market, which is a notorious fact.



(Narrative Testimony of C. G. Brown)

I am content to leave the matter of whatever weight that tax appraisal shows with the court. (T. 128-130.) [98]

The Court: "I am just wondering whether, in 1939, this land could be sold for that price, the land exclusive of any buildings, had the buildings been removed.

Mr. Bryant: One would have to judge the number of lots that could be carved out of the property and then take the market value of each of those lots for residence purposes, and I think at that point you would arrive at a fairly accurate market value as to the whole property.

The Court: "Let's see; the frontage is how much on Third Street?

Mr. Bryant: "200 feet. Isn't it?

Mr. Overton: "250 feet part way back.

The Witness: "247.

The Court: "If the owner undertook to carve out lots, in 1939, for residential purposes, it would seem to me that he would attempt to avoid having a frontage on Third Street and the chances are that he might take a chance, for example, or the risk of carving out one lot facing Third Street and all the other lots fronting on Rossmore, which would mean perhaps the lots would have a depth of about 190 feet. In that neighborhood that wouldn't be unreasonable.

Q. By Mr. Kumler: "What did you say the frontage was on Rossmore? 712?

A. "That is correct. They are 200 feet deep on Rossmore.

The Court: "I think you will find that the lots on Rossmore have considerable frontage. I am not sure whether they are 100 feet on the average or not. But

(Narrative Testimony of C. G. Brown)

wouldn't you say, Mr. Brown, that, in 1939, if one were seeking to carve up this tract for residential purposes, the best chance of getting the most money out of the property would be to carve it out in some such fashion? Is that about right?

The Witness: "If you were unable to sell it as a school. If you do that, the salvage value of the buildings is very small, five or ten thousand dollars. And then I would give it considerable study. I think you probably would end up by offering sites there 75 to 100 feet. You would have to put it on an R-1 basis, single family residences.

The Court: "And wouldn't your Rossmore frontage be more advantageous (T. 130-131) [99] than Third Street?

The Witness: "The name is much better, if you could find a customer who wanted an extra-sized lot and would be glad to have that extra frontage on Third Street and pay for it and join it to his Rossmore frontage, where he might want a tennis court or swimming pool. It is useful as a back yard provided he will stand for the traffic on Third Street.

Q. By Mr. Kumler: "There was something said about the other three corners being vacant.

A. "I am quite well aware of it and have been for several years.

The Court: "In 1939, the properties in that area had shown no real estate activity shall we say ever since about the end of the 20's?

The Witness: "That would be true essentially, your Honor, as to vacant property. There was very little build-

(Narrative Testimony of C. G. Brown)

ing on it. That would be essentially true. There was very little building there. But, as one factor to be considered there, there are very few vacant lots in Windsor Square and a lot of people want to locate there. I know one banker that lived much farther out and he moved down in that part of town to get closer downtown. The principal reason that these three corners are vacant is that they were held originally probably at too high a price and then the traffic came along and kind of dulled it for residential purposes. Personally, unless you want to take a long gamble on the future, I don't think that corner there has any value over the inside property.

The Court: "Up to 1939, would you say that, among the buyers who would be interested in building the type of home such as has been built on Rossmore, by far the greater percentage of those buyers at that time were looking for homesites much farther west?"

The Witness: "I believe that is true. However, may I qualify my answer by saying that building was pretty much out during the period from 1930 to 1940? They would buy out west with the idea of building when they got around to it and were hard up and hoping they would get the money to build a nice home. They liked the sound of "Beverly Hills" or "Bel Air" or something like that.

"In fact, in real estate parlance, it is probably correct to say that the same lot is worth 25 or 40 or 50 per cent more if it is in Beverly Hills than (T. 131-133) [100] if it is in West Los Angeles. It is the name of Beverly Hills. The buyers that would have bought in there ordinarily don't like those corners on account of the traffic

(Narrative Testimony of C. G. Brown)

and that is the reason they stayed vacant. But you will find very few inside lots in that district that are vacant.

The Court: "Of course, you are talking about the improvements that took place prior to 1930, aren't you, that is, the homes to which you are referring in that neighborhood were built prior to 1930, were they not?"

The Witness: "Most of them were built before 1930."

The Court: "Wouldn't you state 95 per cent of them were?"

The Witness: "Somewhere around there."

The Court: "Was there any appreciable building of homes of that kind after 1940?"

The Witness: "I am trying to think of some that went up in there. There were not very many. Not many began to show up and, also, material began to disappear. Why I attach \$80 a foot to that inside property is because homes in there will sell and I reason from that that a vacant lot across from the Country Club must have some appeal to a possible buyer. Getting down to today, it wouldn't now at all because building costs are out of reason but in 1939 and 1940 the people were hard-pressed for ready cash. However, the supply of vacant lots in that district is so very limited. You can drive a long ways before you can find an inside lot that is vacant. There ought to be some purchaser for that. And the real estate men out there—in fact a couple of them have told me \$100 a foot was their price. I feel I was justified in discounting that a little bit, from previous experience and other reasons, and to put it in at \$80 a foot. But a lot 200 feet deep and nice buildings on there becomes very high-toned in that neighborhood in the way of buildings."

(Narrative Testimony of C. G. Brown)

The buildings are much larger on June Street and the properties have a very elegant appearance. Rossmore has nice houses. I have driven people up Rossmore and remarked about the well-kept condition of the houses. There must be a class of people in there a prospective buyer would like for neighbors, and I believe \$80 a foot would move them.

Q. By Mr. Kumler: "Do you know that the second lot north of the (T. 133-135) [101] school, the 100-foot lot, is vacant at the present time? Did you notice that fact when you examined the property?"

A. "No; I didn't. I believe there are scattered vacant lots in there and there are some on Rossmore but the exact location of them I haven't in mind at this time.

The Court: "Is this a valuation as of today or as of August, 1939, which you have given?"

The Witness: "1939 and 1940. I have put on a very small increase in building costs there for 1940, 4 per cent in some cases and in some cases less.

The Court: "In that study, did you find there were any real estate sales in that vicinity in 1939 and 1940?"

The Witness: "I didn't search for sales for the reason I did not have time. There have been sales from time to time in that district.

The Court: "How far back?"

The Witness: "All along an occasional sale. Especially the houses are moving all the time.

The Court: "I am not talking about 1944 and 1945. Would you say that there was any appreciable number of sales in that vicinity in 1939 and 1940?"

The Witness: "Of vacant lots?"

The Court: "Of vacant lots.



(Narrative Testimony of C. G. Brown)

The Witness: "Very few. There are very few vacant lots there and the market was very slow from 1939 up until this war money, and that hasn't made a great deal of difference. But there have been a few sales of vacant property.

Q. By Mr. Kumler: "Did you hear Mr. Mann's testimony yesterday that he sold a lot abutting on the Country Club grounds there, which I think was a hundred feet frontage, for a price of around \$9,000, abutting directly on the Country Club grounds?

A. "I heard him say that but I was busy making some calculations and trying to keep out of sight of the court, and I didn't catch it all. There is your \$90 a foot. (T. 135-136.) [102]

Q. "Would that be considered choice property next to the Country Club there, say on Hudson?

A. "Hudson and Third? If you will describe it to me, I might make an estimate.

Q. "Well, Hudson runs part way along the Country Club and there is another street in there that I don't recall the name of.

A. "Do you mean across the street from the Country Club?

Q. "Speaking of that general area in that vicinity, is that considered choice real estate?

A. "Very good. The values pick up as you go west from Rossmore for a block or two. And a country club across the street never hurts a residential property.

Q. "I am wondering, being a layman at this sort of thing, whether that would represent a ceiling for that area if that were the fact?

(Narrative Testimony of C. G. Brown)

A. "Well, values don't run according to mathematical exactness, if that is good English or good construction. Sometimes somebody wants to sell a lot in a hurry and he will put a low price on it. And sometimes somebody else will want a lot right bad and somebody has it listed at a high price and he will buy it anyway. You will find sales vary in price and you cannot do a messenger boy's work and take a bunch of sales and average them. You have to know the circumstances connected with each sale and should know the market. The real estate dealers, and the brokers in general, if they are competent, can put their finger on the selling price of land pretty closely. (T. 136-137.)

"In considering the possibility of selling the school I considered its use as a boys' school. I don't know whether it is limited to girls' use or not. I figured just a school. (T. 137.) If it were true that a boys' school would require a substantial amount more property for additional outdoor facilities, than the land was capable of handling and that there would be additional noise connected with a boys' school that would affect my value very little. Paige Military Academy is cramped for room and that is a boarding school. They have considerable room there; a big tennis court 175 by 125, paved, and a smaller tennis court and I believe a third one. While there is (T. 138) [103] hardly room to play baseball, you could get a lot of exercise there. And they have a gym too. If we assume that additional space were needed to properly run a boys' school it would affect my value a small amount. (T. 138.)

A. "A small amount; yes.

Mr. Kumler: "I think that is all, your Honor.

(Narrative Testimony of C. G. Brown)

The Curt: "I notice that in this Exhibit B is a reference to a gymnasium which was given a reconstruction value of \$20,000. It is not clear to me whether or not that building was included in the valuation given to us by Mr. Austin or not. Can counsel refresh my recollection on that?

Mr. Kumler: "Yes, your Honor,; that would be. The gymnasium was a part of the main school building, as you will notice when you view the premises, and that was included in his consideration.

The Court: "In other words, the main building that is referred to in Question 1 included this gymnasium insofar as Mr. Austin's testimony was concerned?

Mr. Kumler: "That is right.

The Court: "It is this segregation that has confused me.

Mr. Kumler: "The segregation here, I think, is perhaps on a different basis, on a different physical basis, in viewing this property. Mr. Austin had in mind the plans which he prepared when he erected the main building, which includes, as I understand, the gymnasium. Is that correct?

Mr. Overton: "Yes, sir.

Mr. Kumler: "His figures on the replacement cost comparable to what is included here in No. 1 would include the gymnasium.

The Court: "That would mean that Mr. Austin's conclusion represented a lesser estimate than Mr. Brown.

(Narrative Testimony of C. G. Brown)

Mr. Bryant: "I don't think there is a material difference, your Honor. I think it might be \$60 less than Mr. Brown's. However, you will notice in Mr. Brown's appraisal is a replacement cost of the main building and that includes the gymnasium. Does it not?

The Witness: "No; the gymnasium is separate. No; it is carried in Question 2 as the same. I simply segregated them in making my calculations (T. 138-140) [104] but they are all in Question 2 there.

Mr. Bryant: "You carried down the cost of the main building, \$250,000, from Question 1 to Question 2?

The Witness: "That is right.

Mr. Bryant: "Then, you add to that \$21,000 for the gymnasium?

The Witness: "That is right. And No. 1 does not include the gymnasium.

The Court: "If you take the 1939 balance which Mr. Brown has given with this, the reconstruction cost of the main building plus the gymnasium, in 1939, it would be \$265,000.

Mr. Kumler: "I would understand that.

The Court: "Is that what you wish us to understand, Mr. Brown?

The Witness: "I am sorry, your Honor; I didn't catch the first part.

The Court: "Let the reporter read it.

(Record read by reporter.)

The Witness: "That is correct.

(Narrative Testimony of C. G. Brown)

The Court: "Mr. Austin gave us a figure of \$255,-188, is that correct?

Mr. Kumler: "I think that is correct.

The Court: "And then on the other building, which is called the auditorium, Mr. Austin gave us the figure of \$75,306, and your figure, Mr. Brown, is 96 per cent of \$95,380?

The Witness: "No; 96 per cent of \$89,000, which brings it down to \$85,000.

Mr. Kumler: "Your Honor will recall Mr. Austin also testified that his estimate or his determination of replacement cost of the main building of \$255,188 was exclusive of pergolas and terraces, for which he would add \$14,000. Those are not broken down in this determination.

The Court: "You have included, have you, in your estimate the pergolas and terraces?

The Witness: "Yes.

The Court: "Then I guess Mr. Bryant is right when he says the valuations are pretty close. (T. 140-141.) [105]

#### Redirect Examination—C. G. Brown

"Assuming that the deed from Hancock to Marlborough Corporation restricted the use of the property to a first-class school for girls, and that its use other than that was restricted to an R-1 use, my estimate of the market value of the premises would be changed. It [the deed restriction] would have no bearing on the R-1 use. For selling purposes under Question 5 [Defendant's



(Narrative Testimony of C. G. Brown)

Exhibit B] that would lower it. If it is to be used for girls, you are going to cut down your prospective number of buyers. I would lower my value, say, 20 per cent. That is a better school for girls; that plant is suited for girls. Boys might like a parade ground and a military school would have one. Boys like to play baseball and make a lot of racket and do need a little more room so that the sound of their noise wouldn't put the adjoining property owner up in arms. So it is primarily an establishment for girls. I think if I lowered that 20 per cent it would be safer. 15 per cent might be a better figure. My estimate was made more upon the basis of a girls' school than a boys' school. If I were hunting a purchaser, I would look for someone who wanted a girls' school, primarily a day school for girls. (T. 142-143.)

Recross-Examination—C. G. Brown

I did state that in arriving at the figure shown in defendant's Exhibit B, I took into account boys' school uses. In fact that question had not come up in my mind but I would prefer to say that 15 per cent discount would be enough over these figures I have given. (T. 143-144.) [106]

\* \* \* \* \*

The foregoing testimony was considered by the Honorable Jacob Weinberger from a reading of the transcript of the proceedings before the Honorable Harry A. Hollzer. Judge Hollzer heard the testimony on September

(Narrative Testimony of C. G. Brown)

25, 26 and 27 of 1945. Judge Weinberger, the Judge who rendered the decision in this case, examined the transcript, as stated above, the Stipulations of Fact entered into in the matter, and the exhibits filed therein. On December 16, 1946, the Honorable Jacob Weinberger heard the testimony of Eugene Overton, the President of the Plaintiff corporation, in connection with the matters testified to before Judge Hollzer.

The testimony by Mr. Overton on that date is hereinafter set forth in narrative form. It is partially a duplication of the testimony previously set forth herein. [107]

\* \* \* \* \*

The foregoing Narrative Statement of the Testimony is submitted by plaintiff, Marlborough Corporation, pursuant to the provisions of Rule 75, Rules of Civil Procedure for the District Court of the United States.

DEMPSEY, THAYER, DEIBERT & KUMLER

By William L. Kumler

Attorneys for Plaintiff

Service of the within Narrative Statement of the Testimony is hereby acknowledged this 2nd day of March, 1948. James M. Carter, United States Attorney, E. H. Mitchell and George M. Bryant, Assistant U. S. Attorneys, Eugene Harpole and Loren P. Oakes, Special Attorneys, Bureau of Internal Revenue, by E. H. Mitchell, Attorneys for Defendant. [111]

[Endorsed]: Filed Mar. 2, 1948.

[PORTIONS OF THE TRANSCRIPT OF  
December 16, 1946]

Tr. 3, lines 2-11:

"The only thing that the court mentioned at the previous hearing was that perhaps he would like to hear the testimony of Mr. and Mrs. Overton, who are the persons whose intent, in substance, is in question in this case.

The Court: "I think I would like to have from Mr. Overton a summary, not too much in detail because we have the evidence now in the transcript, but I would like to have him make a statement, for my benefit, in review of what his status is and what his position is."

Tr. 3, lines 20-22:

"EUGENE OVERTON,

a witness for the plaintiff, being first duly sworn, testified as follows:"

Tr. 5, line 6 thru Tr. 6, line 12:

The Court: "When was the first time that the government took the position that it has taken?

Mr. Thayer: "For the year 1939.

The Court: "And had anything similar to this, for which the government had taken this position, occurred prior to 1939?

Mr. Thayer: "To the best of my knowledge, no.

"Direct Examination

By Mr. Thayer:

Q. "Mr. Overton, can you answer that?

A. "No; it had not.

The Court: "And this was the first time, then, that you ever set this additional amount aside for the needs as stated in your testimony?"

## (Narrative Testimony of Eugene Overton)

The Witness: "No, your Honor. Over a period of years, the corporation has been trying to build up a surplus against future probable needs of the business; but, in 1939, that is the first time that this was ever questioned by the government. [4\*]

The Court: "The first time it was questioned?"

The Witness: "Yes, sir.

The Court: "That is to say, you had previously performed some acts in relation to your surplus which had never been questioned?"

A. "That is correct.

The Court: "In the same proportion or not?"

A. "In proportion to the profits of the corporation. Each year we established a policy, when the corporation got out of debt, which I think was about 1935, or supposedly out of debt, about 1935, I think, of then building up out of profits a surplus to guard against and protect against future contingencies in the needs of the business."

Tr. 6, line 16 thru Tr. 24, line 2:

Q. "By Mr. Thayer: Mr. Overton, what is your official capacity with the Marlborough Corporation?"

A. "I am president of the Marlborough Corporation.

Q. "How long have you occupied that office?"

A. "Since, I think, 1924.

Q. "Who is the officer primarily concerned with the financial problems of the corporation?"

A. "I am.

The Court: "I think that was developed in the testimony and I have read that portion of the testimony.

## (Narrative Testimony of Eugene Overton)

Mr. Thayer: "While we are waiting for an exhibit to come in, Stipulation No. 1 in the case shows that, on August 31, 1939, the book surplus of the corporation was \$194,344.60 and that on August 31, 1940, the book surplus was \$213,632.92. Now, will you explain to the court, Mr. Overton, just how these surpluses had been accumulated, that is to say, what was the purpose in building up these amounts instead of distributing them as dividends?

A. "I don't remember the amounts that you stated but [5] the purpose, your Honor, was to provide against contingencies such as fire, earthquake and the possibility, almost, you might say, probability, of having to move the school to a new location, renovation, repairs and new buildings and things of that kind. Do you want me to elaborate at all on that?

Mr. Thayer: "Although we don't have the official exhibit here, I have a copy of it here and probably Mr. Bryant might examine it—or I see the clerk has the papers here. Plaintiff's Exhibit 1 in evidence is entitled, 'Policy Memo Re Reserve Fund.' It reads, 'It has been for many years and still is the purpose of the stockholders and directors of Marlborough Corporation to accumulate and establish a reserve fund in cash and/or liquid securities to provide for probable future business requirements and contingencies. So far as can be foreseen at the present time, these probable business requirements and contingencies are believed to be as follows.' Then you have a list of seven items on here and I will ask you to go through those items and explain to the court the reason why these were set forth. Would your Honor care to see these first?



(Narrative Testimony of Eugene Overton)

The Court: "Is there a date on here?"

Mr. Thayer: "That is an undated document, your Honor, and the record at the present time shows that it was prepared probably sometime about 1938. There is a second one, prepared in the year 1939, which is found in the minute books, which differs slightly from the figures shown there. The figures, to my mind, are not as important in the case as the policy.

Q. "Will you just go through those, Mr. Overton, and tell the court, in your own words, why each one was set up and what you had in mind in filing it?"

A. "The first one is possible fire loss not compensated for by insurance, estimated at \$20,000. I think the amount of insurance that was carried at that time, fire insurance, was about 190,000. [6] My figures are estimates, your Honor.

The Court: "That seems to be about what you stated then.

A. "And it was my opinion when I discussed these with Mrs. Overton, and I think she relied on my opinion more than on her own, that, in the event of a fire loss, the amount of insurance coverage would by no means cover the total loss. In other words, it is almost the case generally in fires the insurance does not cover the loss. And the buildings, one of them particularly, what is called the main building, is a very bad fire risk. It is a frame building with stucco on the outside. No. 2, remodeling buildings in the event it is decided to eliminate the boarding department, and for other contingencies, estimated, \$15,000.

The Court: "That boarding department, of course, has been eliminated?"

(Narrative Testimony of Eugene Overton)

A. "That has been eliminated. And the cost ran way in excess of the 15,000. Do you want any further explanation on that?

Mr. Thayer: "I think that your Honor developed that testimony in the prior hearing.

A. "I think so; yes. The next one is additions to buildings or new buildings that may be required, estimated at \$35,000. My recollection is that that had to do, very largely, with the gymnasium and other minor matters. The gymnasium needed a great amount of additions and doing over entirely, such as paneling. That has all been done since and I don't know what the cost of it was. In fact, I doubt if that would be competent testimony in this case but at least at that time we estimated that the cost of that and other smaller matters would run to at least \$35,000. By the 'gymnasium' I meant a lot of other things, wash rooms and things of that kind. I [7] don't think it has all been done yet. Then, 4, to provide for working capital if the present lease on the school should be terminated, \$50,000.

The Court: "You say 'present lease.'

A. "Yes; that was the lease at that time. That lease was terminated in June of 1944 and at the time this memorandum was made we estimated that, to provide the working capital that would be needed when the lease terminated and when the corporation took over the operation of the school, it would require at least \$50,000. Just as one example, the summer expenses in that school for ordinary upkeep, repairs and things of that kind, payment of teachers' salaries and upkeep of the premises generally—

## (Narrative Testimony of Eugene Overton)

Mr. Bryant: "Just one moment. I think, merely for the purpose of keeping the record straight, we should confine it to the expenses as they were at that time, if you will, please.

A. "That is what I meant, the expenses at that time. They usually ran between twenty and twenty-five thousand dollars, just the ordinary operating expenses, painting and things of that kind, every summer. Then we knew that, if and when the corporation took over the school, there would have to be a great deal of other renovating outside of the ordinary summer expenses.

The Court: What summer repairs did you make prior to that time? Were they extensive repairs or just the ordinary painting?

A. "Just the ordinary painting and minor repairs.

The Court: "Approximately how much did you spend every year for summer repairs?

A. "I can't tell you on repairs, your Honor, but maybe Mrs. Overton could do that. [8]

The Court: "Repairs and renovations?

A. "Repairs and renovations and the payment of salaries, and those things always ran in the neighborhood of twenty to twenty-five thousand dollars.

The Court: "You had no summer school?

A. "No summer school; no.

The Court: "And these summer repairs were paid out of your operations the same as other expenses. Is that correct?

A. "That is correct.

The Court: "Were those items charged as expenses, expenses of operation?

A. "Oh, yes.

(Narrative Testimony of Eugene Overton)

The Court: "The same as the other?"

A. "Yes.

The Court: "And the profits that you earned were in excess of all these expenses all during this time?"

A. "I think your Honor is confused. You see, at that time, in 1939 and 1940, the Marlborough School was leased by the corporation to a Miss Ada Blake.

The Court: "Yes. But that lease had been in existence only a few years, hadn't it? How many years was it?"

A. "No; it had been in existence since 1924.

Mr. Thayer: "I think the record shows 1925.

The Court: "And it expired in 1942?"

A. "It expired in 1942; yes.

The Court: "I understand.

A. "While the lease was in existence, the lessee Miss Blake was required to take care of all of those summer expenses and make the repairs and pay the salaries and so forth. What was anticipated by this memorandum was that, if and when the corporation took it over after the termination of the lease, it would have to have money set aside to make those repairs and pay the summer expenses and so forth. [9]

The Court: "From 1942 on?"

A. "From 1942 on. And that was the reason for building up that reserve for that purpose.

The Court: "This tax period covers the years 1939 and 1940?"

A. "Yes.

The Court: "August 31st?"

A. "Yes. And we at that time were building up against the day that the corporation would have to take over the school.

(Narrative Testimony of Eugene Overton)

The Court: "That was the period of time, 1939 and 1940, that the lease was still in operation?"

A. "The lease was still in operation then.

The Court: "And you determined upon this method of providing for your future needs while the school was under lease?"

A. "That is correct.

The Court: "Anticipating that you would run it yourself in 1942, is that correct?"

A. "That is correct.

Q. By Mr. Thayer: "Mr. Overton, isn't it true that the lease actually expired the 1st of September, 1942, rather than at the end of the spring term?"

A. "Yes; by its terms. But it was agreed between the lessee and the corporation that it should be terminated as of some date in June, I think about the middle of June, 1942.

The Court: "Who knew about your plans other than yourself and Mrs. Overton?"

A. "Nobody. Mrs. Overton and I are the corporation.

The Court: "Have you any advisory board of any kind?"

A. "No. The stock is entirely owned by Mrs. Overton and myself and I think my secretary is the other director.

The Court: "It is a family corporation? [10]"

A. "A family corporation.

The Court: "You have conducted this school as a private enterprise, of course, for school purposes?"

A. "Yes.



(Narrative Testimony of Eugene Overton)

The Court: "That is, you have never anticipated incorporating this into some school wherein the public would be admitted, as oftentimes happens in schools that are established with a board of trustees and the like, even though they are private schools? You have never had that in mind?

A. "Yes. As it happens, your Honor, we have given that very serious consideration. We haven't arrived at a definite plan. Mrs. Overton and I discussed the advisability of doing exactly what your Honor has in mind, getting a board of trustees to take over the school and probably giving the school to it, with the idea of perpetuating it. We have not formed any definite plans. I discussed that, Mrs. Overton and I, with several businessmen in the last two or three years. It is a very difficult thing to decide and to work out.

The Court: "But, as the corporation now functions, you can, if you want to, close the school tomorrow and sell your assets and do as you like about your own affairs?

A. "That is correct.

Q. By Mr. Thayer: "Will you continue with this, Mr. Overton? I think you had gotten down to No. 5.

A. "Yes; 5, to provide for obsolescence and depreciation, which is \$75,000. That is very much of an estimate and, if I may say so, it is an exceedingly low estimate. That school was built, the main building, in 1916. As I stated, it is a frame building, subject to quite heavy depreciation.

The Court: "What depreciation did you deduct before?

(Narrative Testimony of Eugene Overton)

Mr. Thayer: "That will be shown in the stipulation, your Honor. If I might use just round figures here, something in the neighborhood of \$7,000, wasn't it, Mr. Bryant? [11]

Mr. Bryant: "I am trying to find it.

Mr. Thayer: "It would be a composite percentage but the depreciation is that which had been allowed by the Internal Revenue Department. So, presumably it was correct and the record reflected on the books.

Mr. Bryant: "Around \$6,500, 1939.

The Court: "And what per cent would that be?

Mr. Thayer: "If I might have a moment here. I think I can figure it out. On Defendant's Exhibit C, a copy of the return for the year 1939, the depreciation rates are shown on the stucco frame buildings as  $3\frac{1}{3}$  per cent. These are on costs. On the concrete auditorium,  $2\frac{1}{2}$  per cent. On auditorium fixtures, none shown. Plant and machinery only had one year to go. So that was completely written off during the year. On furniture and fixtures, that were required at various times, the rate was 10 per cent generally. Taking the total figure for the year, we have a depreciation allowed and claimed of \$6,500, as against a total investment of \$240,000.

The Court: "Including the lands and buildings:

Mr. Thayer: "No, sir. Land is not depreciated, your Honor.

The Court: "You say your total investment?

Mr. Thayer: "That is just in depreciable property, with a \$6,500 allowance, or, roughly,  $2\frac{1}{2}$  per cent, composite.

(Narrative Testimony of Eugene Overton)

The Court: "All right.

A. "Shall I go on?

The Court: "Yes.

A. "One of the main items had in mind at that time was the possibility that the school would have to be moved farther to the west. There is in the record an exhibit or a tabulation that I prepared showing the westward growth based on the residences of the pupils attending the school, and it [12] shows that, from, I think it was since about 1928—I have a copy of that in my briefcase, I think.

Mr. Thayer: I believe we have it attached to the stipulation.

The Court: "I think that is developed in the testimony.

Mr. Thayer: "It is set forth in the stipulation, your Honor.

A. "That record shows, your Honor, as your Honor knows, that the residences of the pupils, in the last number of years, have shifted from a preponderance east of the school to a preponderance west of the school, and a great many of them come from Westwood, Beverly Hills and that general area, which is a long way to go to school. Now, that is something that is extremely important to keep in mind and figure on, I mean from our standpoint, because the past history had one such instance of that kind. This school was established by Mrs. Overton's mother, Mrs. Mary S. Caswell, first in Pasadena and then moved into Los Angeles and was down on Twenty-third Street, a few blocks west of Figueroa Street. In 1916, or sometime prior to 1916,

(Narrative Testimony of Eugene Overton)

Mrs. Overton's mother realized that the population was moving away from her, moving away from the school, and, without going into a great deal of detail—

The Court: "I have seen that in the testimony.

A. "—the school was moved to its present location in 1916. When that was done, my mother-in-law had not established any reserve such as we have been attempting to establish or have to some extent. And she found herself in an extremely difficult financial position. And there, again, without going into detail, which I think is all in the testimony, after a great deal of difficulty and a great deal of work on [13] my part, it was finally straightened out. That was in 1939. And then it still is a very serious consideration whether or nor the school will eventually have to be moved. If it does have to be moved, it will require a great deal of money, and much more than the estimate I have set up there. That is what I had in mind mainly in the one figure which I have called obsolescence and depreciation. ..Your Honor understands probably from reading the testimony that this was merely a memorandum prepared for my own uses and not one that I intended to have made public or to come into court with. Otherwise, it would have been more detailed.

The Court: "Was there some reason why you didn't make such plans some years before or was it because it was under lease?

A. "We did, your Honor. We had that in mind ever since almost the school moved or a few years after the school moved to its present location. And, eventually, considered the westward trend, which was very marked even then, the school would again have to be moved and we were building up a reserve against that contingency.

(Narrative Testimony of Eugene Overton)

Q. By Mr. Thayer: "You say a few years after the school moved. About what year would that have been?

A. "The school moved, Mr. Thayer, as I said, in 1916, and I would say that by 1925, although that is somewhat of a guess—I don't know when it commenced to crystalize in our minds—the trend westward was very marked and we had that in mind. We were not able in those days to build up a reserve because we had to pay off the debts.

Q. "You say when you started to build a reserve back as early as 1925?

A. "No; the starting to build a reserve started right after we had paid off our indebtedness, and I think we paid [14] off our indebtedness in '34 or '35, that is, the indebtedness incurred by reason of having to move the school in the first place.

Q. "So 1939 and 1940 were no different to any other years as far as your ideas of what you were going to do were concerned?

A. "That is correct.

Q. "Will you take the next two items? I think 6 is the next one.

A. "6, to provide for earthquake damage, as no earthquake insurance is carried, estimated at \$20,000. I doubt that that needs any explanation, your Honor. That is one of those contingencies that I think any smart or careful businessman will provide against, particularly if he doesn't carry earthquake insurance, which, as your Honor knows, is extremely expensive. The next one, 7, indebtedness to Mark Overton, Georgia C. Overton and Eugene Overton, \$35,500. I stated a few minutes ago



(Narrative Testimony of Eugene Overton)

that we paid off the indebtedness on the school in 1934 or 1935. We did not pay that, in large part, out of earnings of the school. Mrs. Overton and I loaned the school \$40,000, I think it was, with which to make that payment, to pay off the indebtedness, and that is the reason for that indebtedness to us, which we have carried along rather than pay it, because we wanted always to keep a good reserve in the school account against contingencies. The other fifteen, though, is a more complicated picture, your Honor, and has a somewhat sentimental background.

Q. "That has to do with the buying of a ranch?"

A. "No. That has to do with \$20,000 that Mrs. Overton's mother wanted to leave to our grandson. I asked her not to leave it in her will because I didn't want him to get it when he was 21 and asked her to leave a memorandum or a [15] note to Mrs. Overton saying she would like that paid to him. That memorandum, I think, is in the record. And may I digress outside of the record, Mr. Reporter, while I think of it? That was to be returned to me and a copy made and I haven't gotten it.

Mr. Thayer: "The original is in our files and a copy is in the files. Did your Honor want some explanation on that?"

The Court: "It is on that list there, is it not? How does it appear there?"

A. "It doesn't appear as being indebtedness to Mark Overton, Georgia Overton and Eugene Overton.

The Court: "If you wish, you make some explanation of that.

A. "This memorandum that I speak of or this note to Mrs. Overton asked that he be paid \$20,000. At the

(Narrative Testimony of Eugene Overton)

time that we thought he ought to be paid that, which was when he was about to be married, we gave it to him out of the corporation funds, on the understanding the corporation had belonged entirely to Mrs. Overton's mother, which was to carry out her wish. Then, Price, Waterhouse, who were our corporation auditors, objected to the way I had handled it, saying that a corporation can't give away money. Well, I saw no purpose in getting into an argument with Price, Waterhouse, though the corporation had no creditors other than Mrs. Overton and myself. Nevertheless, to meet their wishes, Mrs. Overton and I actually paid that money back to the corporation by having \$10,000 credited on each of our notes. Did I make that clear?

The Court: "That is to say, the corporation paid you and Mrs. Overton so much on your notes, is that right?"

A. "That is right.

The Court: "And you took that money and applied it to your grandson? [16]"

A. "That is correct. So, actually, that money, while we intended to have it come out of Mrs. Overton's mother's estate, came out of Mrs. Overton and myself.

The Court: "But you have the stock, nevertheless, haven't you?"

A. Oh, yes; we have the stock.

The Court: "That would have been a lien on the stock had it not been paid?"

A. "I suppose it might have been.

The Court: "In other words, if that was the provision of the will or whatever the estate provision was relative to that bequest, the assets were burdened with it?"

A. "Morally burdened with it.

(Narrative Testimony of Eugene Overton)

The Court: "Now, you spoke about a ranch.

A. "At the same time that I had the discussion with Mrs. Overton's mother about her will, she had wanted to leave considerably more to our son and, as I say, I asked her not to do it. He wanted to buy a ranch. Or, before that, let me say this. I told her in fact that we would see that he was properly taken care of according to the way we thought she wanted. He wanted a ranch. This ranch cost \$15,000. There, again, to carry out what we knew were her wishes, we bought the ranch out of the school funds, had it held in trust for a number of years, and finally conveyed it to him. That was \$15,000. That makes up the other 15,000. Have I made that clear? It is rather involved.

The Court: "It is clear enough for this purpose. It may have some bearing as to how you handled the affairs of this corporation.

A. "Yes.

The Court: "That \$15,000 came out of the assets and was charged against your dividends, is that it? [17]

A. "It was charged against profits, I presume. I am not sure how that was charged.

Mr. Thayer: "I believe it was actually declared as a dividend for the year.

The Court: "That is my recollection.

A. "That is correct; yes. Your Honor remembers it better than I. Yes; we declared a dividend to Mrs. Overton and myself of \$7,500 each and paid that to our son or paid it for the ranch.

Q. "And you had theretofore and thereafter declared regular dividends, had you not, in the operation of this corporation?

(Narrative Testimony of Eugene Overton)

A. "Yes.

Q. "And are still doing that?

A. "We are still doing the same thing.

Q. "You have a fixed rate of dividend, have you, or how is it?

A. "It is a fixed rate of dividend. I think it is a dollar and a quarter a share quarterly, \$2,400 a year.

Q. "On a capital stock of \$50,000?

A. "That is correct.

Q. "And these dividends you draw and take them personally?

A. Yes, sir.

Q. "A stockholder's dividend?

A. "That is right.

Q. "This surplus that you are attempting to conserve for these two years, of course, was profits in excess of the dividends declared?

A. "That is right." [18]

Tr. 27, line 14, thru Tr. 40, line 16:

The Court: "What has the corporation done? Has it made a different kind of return than it did for those years?

A. No; we have carried along exactly the policy. I might say this. I think that the corporate books were examined for 1941. Now, I may be wrong in that. But, since the school was taken over by the corporation, that is, in 1942 and 1943 and 1944, it has been operated at a loss. So there would be no question—

Q. By Mr. Thayer: "The question would become moot, then.

A. Yes. I have that exact sum in money, and that was due to items of repairs and renovations that had to be made.

(Narrative Testimony of Eugene Overton)

The Court: "What year?

A. "Since 1942. When the corporation took it over in 1942, when Mrs. Overton started to run it, it was found it was in very bad condition and a great deal of expense had to be gone to to make renovations. Also, of course, salaries and expenses generally increased. So, ever since then, until this year, 1945 and 1946, we are on a fiscal year, from August to August, and the school has lost money.

The Court: "The petitioners have withdrawn their request for a refund on the obsolescence?

Mr. Thayer: "As I understand, your Honor; yes. The sole issue is the liability and penalty under Section 102.

The Court: "There is an entry on your corporate books of this intention, as you have detailed, in 1940, is that right?

Mr. Thayer: "That list, I understand, was made in 1938. I am a little bit green to this myself. I was in service at [19] the time the case was tried. My partner, who tried the case, is back in Washington. All I know is from the record and I know in the record Exhibit No. 2 was then in the minute book. That is a signed policy memorandum similar to the one we have there, made on November 7, 1939.

The Court: "And it was actually made at the time in 1939, was it?

Q. By Mr. Thayer: "Is that true, Mr. Overton?

A. "If that is the date on it.

The Court: "That is to say, this Exhibit No. 2 was a part of the minutes? Was it a part of the minutes or a declaration?



(Narrative Testimony of Eugene Overton)

A. "May I look at it? I think it was not a part of the minutes.

Mr. Bryant: "If I may state, your Honor, that was found among the minutes but it was not actually in the minutes.

The Court: "There was no formal adoption of that policy in the minutes?

Mr. Bryant: "There was no resolution. This witness has testified or put the date that this policy memorandum was made. You will note that is in the second year involved; not the first year. So, when we say the year 1939, we mean the year ending August 31, 1939, and this memorandum was made in the second year involved here, 1940.

The Court: "Was this policy ever ratified or adopted by the corporation as such or by the directors?

A. "Not as a formal action, your Honor.

The Court: "However, you made your return on that basis and that is what brought you to court here, is that correct?

A. "That is correct. Your Honor understands that, like most corporations of this kind, in which there are only one or two or three stockholders, they don't go in for formal [20] actions as much as bigger corporations. I discussed matters with Mrs. Overton and we would go on that basis until it was a title matter or something that had to have formal action.

The Court: "What is there on your books as a separate corporate entity to show you have adopted that policy?

A. "I think there is nothing in the minutes except I made this memorandum and put it in the minute book.

(Narrative Testimony of Eugene Overton)

The Court: "This apparently was a summary by yourself as president.

A. "Yes. That merely carries out, if your Honor please, this first memorandum made a year or two earlier. It shows a continuation of the same policy on our part. That second memorandum, I notice, is for a somewhat lesser sum.

Q. By Mr. Thayer: "Did you have in mind, Mr. Overton, a total you were attempting to accumulate, any fixed figure beyond which you didn't intend to go or you did intend to go? I notice from the record that \$250,000 had apparently been set by you as a figure to show it, is that correct?

A. "That is correct. I have always felt, until the last couple of years, that there ought to be at least \$250,000 set aside as a contingent reserve. Being able to accomplish that was so far in the future that I didn't put those figures down. Now, at the present time, in my own thinking and estimates, I have increased that very materially due to the tremendous increase in building costs and all of those things, and I have increased the insurance very materially in the last year.

Q. "Why, instead of accumulating earnings as you did for the years, didn't you simply wait until one of these contingencies occurred and then go down to the bank and borrow money for it? [21]

A. I think that is very fully set forth in the testimony. And it is extremely difficult to borrow on this type of business enterprise and on this type of property, being a sole purpose building; extremely difficult. And that was shown by the trouble I had making the loans

(Narrative Testimony of Eugene Overton)

for my mother-in-law in 1916. In fact, it would be absolutely out of the question to borrow enough money to pay for the moving the school if it had to be done. I can state that very positively.

The Court: "How much of a surplus have you or did you have at the end of 1940?"

Mr. Thayer: "At the end of 1940?"

A. "The book surplus was \$213,692.

The Court: What part of that was represented by this declaration of policy? Or I might reverse the question. What proportion of this amount as shown by the policy is reflected in the amount of surplus on hand at that time?

Mr. Thayer: "It would have been practically 90 per cent at that time. Exhibit No. 2, I think, there shows \$215,000 and they had \$213,000 on hand.

The Court: "However, I notice that Exhibit No. 2 doesn't contain any reference to the dates Mrs. Overton and Mark Overton had been paid off.

A. "No; they haven't been paid off. I guess I forgot about that thing. You understand, this was drawn up more as a memorandum for myself of what I had in mind when I drafted it, and that was, if anything happened to Mrs. Overton or to me, it would serve as a record for our son who would take over. That was the main object at the time.

The Court: "He is familiar with these operations, is he?"

A. "He is not very familiar with it but that is the reason I wanted this in the record, so that he would see what our plans were if anything happened to us. [22]

(Narrative Testimony of Eugene Overton)

The Court: "Is he as interested as you are in the operation of that school?"

A. "I think in the continuation but he has had nothing to do with the operation. I have discussed things with him from time to time.

Q. By Mr. Thayer: "Under your lease with Miss Blake, as shown by the record, the lease was to expire at the end of August, 1942. In 1939 and 1940, did you have any intention of renewing the lease to Miss Blake or entering into a new lease with anyone else?"

A. "We were not decided at that time as to whether to renew the lease or let it terminate. We didn't come to a definite conclusion until some time early in 1942.

Q. "You had no plans then, either negative or affirmative, as to the operation of the school by the corporation at that time? It was merely one of those contingencies, as set forth in your policy memorandum, is that correct?"

A. "That is correct. We had discussed it at considerable length, Mrs. Overton and I. As I say, we were undecided. We rather hoped that we would feel justified in renewing the lease to Miss Blake when the time came.

Q. "Has the corporation ever loaned any money to either you or Mrs. Overton or your son?"

Mr. Bryant: "We have stipulated, your Honor, that it has not.

A. "May I correct that stipulation?"

Mr. Bryant: That is in the original stipulation.

A. "Yes, but at the last trial, I first testified to that effect and then, over the noon hour, I found in the minutes that \$1,000, sometime in, I guess 1935 or something, had been loaned to Mrs. Overton and paid back

(Narrative Testimony of Eugene Overton)

in five days. So I called that to the court's attention. That is the only one. [23]

Q. By Mr. Thayer: "Who determined the amount of dividends to be paid through the years 1939 and 1940?

A. "That had been by a resolution of the board of directors sometime previously.

Q. "Who were the board or the members of the board?

A. "I don't remember who were the actual members of the board. There was a period Mrs. Overton wasn't on the board and my secretary and one of my law partners were. But it was actually determined by a conference between Mr. and Mrs. Overton.

Q. "In that conference between you and Mrs. Overton in determining this dividend policy, did you and she, or either of you, consider the income tax effects of the payment of the dividend or the withholding of the payment of a dividend?

A. "Will you state that question again?

Q. "In your discussion with Mrs. Overton in determining the amount of this dividend to be paid, did either you or she consider the effect of the payment of the dividend on your own personal income taxes?

A. "No; we never took that into consideration.

Mr. Thayer: "Your Honor, I think that summarizes the testimony of Mr. Overton as it appears in the record. I know there are many holes in this testimony but I don't think we have brought out anything new. I wonder if that is what your Honor has in mind.

The Court: "It emphasizes the matters, in a short period of time, which would take a consider period of time to read into the record. You and Mrs. Overton, of



(Narrative Testimony of Eugene Overton)

course, have means and income other than that derived from your dividends in this corporation?

A. "Yes. I, of course, have my law practice and some income outside of that and Mrs. Overton has some income outside of her own. [24]

Mr. Thayer: "Do you wish to cross-examine?"

Mr. Bryant: "Yes, when you are finished."

"Cross-Examination

"By Mr. Bryant:

Q. "Mr. Overton, during the taxable years in question, that is, the years ending August 31, 1939 and August 31, 1940, did you operate the school yourself or did the corporation operate the school?"

A. "No.

Q. "It was operated by Miss Blake practically all within that time?"

A. "That is correct.

Q. "And upon your return—have you inspected this return?"

A. "Which return is that?"

Q. "The 1939 return.

A. "I did a long time ago. I think I signed it, didn't I?"

Q. "Yes.

A. "Yes.

Q. "You took no deductions for salaries paid? The corporation had no active operations?"

A. "The corporation paid no salaries. There, again, we wanted to accumulate all funds possible in the corporation and build up a surplus, and neither myself nor anybody else took any, as I recollect.

(Narrative Testimony of Eugene Overton)

Q. "And what function was the corporation performing during those years?

A. "Do you mean as to the school?

Q. "As to the school? [25]

A. "Merely supervisory. Under the terms of the lease, the corporation had considerable supervisory powers. Mrs. Overton at times would go to the school and look things over; maybe not as much as it develops now should have been done. And questions of policy in the running of the school and changes in policy which the lessee Miss Blake wanted to make were covered by the lease and had to be approved by the corporation. And there were a number of instances in which those questions came up and consultations were held between Mrs. Overton, Miss Blake and myself, as to those changes or proposed changes in policy. Then I had numerous conferences with Miss Blake on financial matters, made quite a number of changes and modifications of the lease that she asked for, and attended to various legal matters that came up. I remember that Judge Hollzer asked me if I ever charged for that. I did not. That I think about covers it, Mr. Bryant. I think that is quite fully set forth with a good many examples in the testimony.

Q. "And, in regard to your lease, your functions were advisory to Miss Blake, who was the actual operator, were they not?

A. Advisory and supervisory, that is, under the lease we had considerable powers of supervision.

The Court: "Was she paying you a rental?

A. "She was paying us a rental, a fixed rental and a share of the profits.

(Narrative Testimony of Eugene Overton)

The Court: "Under a written lease?"

A. "Under a written lease.

Q. By Mr. Bryant: "That is in the record, the lease, is it not?"

A. "I think it is. [26]"

Mr. Thayer: "It is Exhibit A of the third stipulation.

The Court: "And she did make a profit during her operation?"

A. "Over all; yes. I think there were a few years when she didn't but I am not sure.

Mr. Bryant: "This is the only remaining question I have—

The Court: "Mr. Bryant, had this money which was set up on which is in controversy here been distributed to stockholders, have you any calculation as to the difference—

Mr. Bryant: "Yes, sir.

The Court: "Is that of record?"

Mr. Bryant: "I believe it is in Stipulation No. 3. It is sixteen hundred and some dollars as to one taxpayer. Paragraph IV of the stipulation reads, "That the accumulations of plaintiff prevented the imposition of surtax upon plaintiff's shareholders in the sum of \$2,402.99 for 1939 and \$4,199.68 for 1940." That covers both shareholders, both Mr. Overton and Mrs. Overton.

The Court: "That would have created an additional tax on the two of approximately \$6,000?"

Mr. Bryant: "That is right, your Honor.

The Court: "What year was that?"

Mr. Bryant: "That is for two years.

The Court: "But the amount involved in this proceeding is about \$7,000, is it not?"

(Narrative Testimony of Eugene Overton)

Mr. Bryant: "That is correct.

Mr. Thayer: It is actually \$8,500, your Honor, \$3,389.85 for the year 1939 and \$5,112.03 for the year 1940.

The Court: "The total amount is approximately \$12,000, less the depreciation item which is deducted, nine hundred some odd dollars? [27]

Mr. Bryant: "Yes, your Honor. I think I have no further questions. The lease is in evidence as Exhibit A and remarks in regard to that are set forth in full in the arguments and also in the testimony. I think the government's position has been presented in that regard and there is no use burdening the court with additional testimony at this time.

The Court: "May I ask this question of you, Mr. Bryant?

Mr. Thayer: "Is your Honor finished with Mr. Overton?

The Court: "Unless Mr. Overton has something additional to say.

A. "No; I think not unless I might make this remark in connection with the remark your Honor just asked as to the additional tax imposed on Mrs. Overton and myself in 1939 and 1940. That is something that I gave no consideration to. Of course, I realize, as any businessman or lawyer would, that the more dividends you get the more tax you would have to pay, but I never figured the amount of it and never knew the amount until you stated it just now. I might explain also that the tax returns of Marlborough Corporation were made out by Price, Waterhouse & Company. The tax returns of Mrs. Overton and myself were made out by an entirely differ-

(Narrative Testimony of Eugene Overton)

ent firm of auditors, Ira Frisbee & Company, and, as far as I know, neither Ira Frisbee & Company nor Price, Waterhouse have conferred on these matters. I wouldn't be sure but I don't think so. But the point I am getting at is this, that that was not taken into consideration in our attitude on paying dividends. I might add this, that, as I stated, I never knew how much more it would be and, as a matter of fact, when my income tax returns are brought in to me by the auditors, I sign them. I don't pay any attention to them because they know more about it than I do. [28]

Mr. Thayer: "A moment ago your Honor spoke of the figure '\$12,000.' I am wondering if you believe that there were \$6,000 for each Mr. Overton and Mrs. Overton. The stipulation, I think, covers \$5,000. Isn't that correct?"

Mr. Bryant: "That is correct."

Mr. Thayer: "So that the total tax assessed by the government under Section 102 is greater than the total tax they would have paid had they distributed all of the income for the year."

The Court: "That is what I understand."

Mr. Bryant: "That is correct, except, also, if the government did not assess the Section 102 tax, they would have distributed the percentage."

Mr. Thayer: "Yes."



Tr. 46, line 10 thru Tr. 46, line 23:

Mr. Thayer: Does your Honor wish to call Mrs. Overton?

The Court: "Her testimony appears in the record, does it not?"

Mr. Thayer: "Yes, sir, and would be simply a summary of her former testimony."

The Court: "I don't think I need it."

Mr. Bryant: "Your Honor understands also that our cross-examination was made in the light of Mr. Overton's testimony here, inasmuch as we had an opportunity to fully cross-examine at the previous hearing. By our cross-examination today I don't want to have it thought that our cross-examination here today was meant to be extensive but only to limiting remarks as made here on the stand today."

The Court: "I don't think that I need anything more." [29]

Tr. 47, line 19 thru Tr. 48, line 6:

The Court: "There has been nothing new developed, then, today?"

Mr. Bryant: "Nothing new developed so far as I now see."

Mr. Thayer: "If the government would wish to do so, I would not oppose a motion to strike all of the testimony as long as your Honor has heard it. It adds nothing to the record."

Mr. Bryant: "If you will, then, we will stipulate that the testimony given here today may be stricken."

The Court: "I don't know that I would concur in that stipulation. I have had a chance to size up Mr. Overton. I like to see a witness personally and then I get a better idea of who he is and what he is thinking about."

The foregoing narrative statement of the testimony as corrected by this Stipulation correcting record on appeal and designating questions and answers to be substituted for provisions of the narrative statement filed hereinbefore, is submitted by the parties pursuant to the provisions of Rule 75, Rules of Civil Procedure for the District Court of the United States.

Dated: April 15, 1948.

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A True Copy. Attest, etc., Apr. 19, 1948. (Seal) Edmund L. Smith, Clerk U. S. District Court, Southern District of California; by Theodore Hocke, Deputy.

[Endorsed]: Filed April 16, 1948. [30]

[Title of District Court and Cause]

Honorable Harry A. Hollzer, Judge Presiding

TRANSCRIPT OF PROCEEDINGS ON INSPEC-  
TION OF MARLBOROUGH SCHOOL PREMISES

\* \* \* \* \*

Los Angeles, California, Tuesday, October 2, 1945,  
2:40 P. M.

The Court: Will you tell us, Mrs. Overton, what room we are in?

Mrs. Overton: This, I suppose you would call it, is the principal's office.

The Court: You were going to tell us something.

Mrs. Overton: I have redecorated it. I have repainted it and the draperies are new. The chairs that are not new are reupholstered. I bought that table and this desk.

Mr. Bryant: Will you just give the articles?

Mrs. Overton: The refectory table and the desk and that chair were already here. This big overstuffed chair is new. This occasional chair here and this one over here are both new and the love seat is new and these three occasional tables are new. The lamp is new and the mirror is new. We had this little chair and the desk chair and that table and that chair which has been reupholstered. Those are the only things which were originally in the building.

The Court: If you will, just lead us on a tour.

Mrs. Overton: I think, if you don't mind, we will start through this way and then we will meet over at the gymnasium while one class or another is out on the

fields, and then we can go through the dressing rooms and lockers. But I think at the moment they will be changing. [2\*]

The Court: Yes.

Mrs. Overton: This is the financial office, which I have redecorated. We built in these lockers. These desks were both here and the files we had.

Mrs. Overton: We just call this the entrance hall.

The Court: In other words, the room where the large table, the round table, is?

Mrs. Overton: Yes. And those chairs were here. This overstuffed chair was here and these two chairs are new and the hangings are new. And this was repapered and painted entirely. And the sofa down there was here but that was reupholstered.

The Court: Mrs. Overton, have there been any fundamental changes in partitions?

Mrs. Overton: Not in here; no. Here we have cut this door through into the hall.

The Court: Referring to what?

Mrs. Overton: This is the vice-principal's office. It was shut off. We built this office for the executive vice-principal. We had to tear out a lot of cupboards to do that and repaper. Those were new hangings. And, except for this one little chair, all of the furniture was here.

Mr. Bryant: What was done with the previous furniture [3] that you had throughout the building?

Mrs. Overton: It was given to the Good Will. We let the help who were here take anything they wanted but most of it was old-fashioned and we couldn't do anything with it. We might have sold a little of it. I couldn't swear to it.

\*Page number appearing at top of page of original Reporter's Transcript.

The Court: Are you referring to the period when you took over the operation of the school in the summer of 1942?

Mrs. Overton: That is when I did all of this; yes.

Mrs. Overton: This is the living room. The living room is redecorated with new hangings. The sofa was here. I reupholstered it. And these two chairs were here. The others are all new. And this table was here.

The Court: All of the rest of the furniture here is new?

Mrs. Overton: Yes.

Mrs. Overton: This is what we call the main office and I painted this and put in new hangings. I don't remember whether this desk was here or whether I bought it. The other furniture was here.

Mrs. Overton: This is the academic vice-principal's office. The filing case was here and the desk was here. I repainted it. And the hangings are new and the two chairs are [4] new.

The Court: Are you referring to the two stuffed chairs?

Mrs. Overton: Yes.

The Court: Were the cabinets here?

Mrs. Overton: The cabinets were here; yes.

Mrs. Overton: I repainted all of these corridors and the class rooms.

The Court: That is done how often, the repainting?

Mrs. Overton: It is awfully hard to say. We touch it up every year where we need it. Sometimes we had a whole wall like that where the little darlings put their sandwiches and their shoes and left marks. I would say



for a real job, probably, I suppose, once in four years about. I wouldn't go on the witness stand and swear to that.

Mrs. Overton: This is the library. All the shelves and stacks are new and that desk is new. The tables and chairs were here. I painted it all.

Mrs. Overton: This is the students' office. We have repainted this quite recently and taken out blackboards and so on and put in this counter. The furniture was all here.

Mrs. Overton: This is Room B, where they study type- [5] writing, and I had it repainted.

Mrs. Overton: There are five reception rooms all along here. They have all been repainted. The furniture was here. I have had the chairs repainted every year.

The Court: In other words, there are five class rooms like this, are there? This is Class Room D, is it?

Mrs. Overton: This is room C. This is one of the five. There are four others similar to it.

Mrs. Overton: This is the west wing of the main building.

Mrs. Overton: This is the senior high art department and this is the junior high adjoining. We took out some partitions and threw two or three rooms into one, and I built all of those lockers out there and put up this Celotex, or whatever that wall covering is, and repainted everything. The tables were here.

Mrs. Overton: This is the junior high art room and we installed the plumbing here and built in all of these lockers and cupboards in there and had all of these things built to sit on. They sit astride. And we put all of this linoleum down also. [6]

Mrs. Overton: I have repainted all of these rooms up here.

The Court: What do you call this?

Mrs. Overton: The chemistry laboratory. We installed this experimental desk. The others were in and the chairs were here. This was two rooms before. There was a partition across here originally and this was a class room and the other was a laboratory, and I threw them into one.

The Court: Did you repaint the room?

Mrs. Overton: Yes.

Mrs. Overton: There is one room there. That I made into a faculty room and a chemistry storeroom, with these shelves and such for the chemicals.

Mrs. Overton: This corridor here I repainted.

The Court: That is the corridor attaching these various rooms?

Mrs. Overton: Yes.

Mrs. Overton: This is a class room which I repainted.

Mrs. Overton: This is the biology laboratory. I built in lockers here and repainted it all. I think that is all I did here. [7]

Mrs. Overton: This is a class room, Class Room M, which I repainted, which they use for a junior high science room. They have a sink and can do little simple experiments. And I put in new lighting fixtures in a great many of these.

Mrs. Overton: This is Class Room No. 1. I have just painted this.

Mrs. Overton: Since we left the biology laboratory, all of these are the junior class rooms.

The Court: This used to be part of the boarding department?

Mrs. Overton: Yes.

The Court: Have you mentioned that?

Mrs. Overton: No; I haven't. It was at one time but these rooms were made before I took it. They have taken away part of the boarding department for these junior high rooms. This used to be a sleeping porch where that division comes, I think. At the time the place was built, there was that fad of everybody sleeping on sleeping porches.

Mrs. Overton: This is one of the junior high home rooms, where the girls have their desks. I painted this. I put in some new desks, teachers' desks, but I can't tell you which ones. The other desks I bought a few of but not very many. [8]

Mrs. Overton: There was a small room at the end and I threw all into one and built in the lockers and shelves and painted it. This is Room 5.

The Court: What did you say you called this room?

Mrs. Overton: This is the reading room where those who have not been very well trained in their grades have special work.

The Court: In other words, this was two rooms and you removed the partition?

Mrs. Overton: Yes. This was a case where we couldn't get any more linoleum. It was out of the question.

Mrs. Overton: This is Room 3 and Room 4, I think. I didn't do anything about this but paint it.

Mrs. Overton: In here there are three little bathrooms belonging to the bedrooms. You can see where I threw three rooms together here and made this lavatory.

Mrs. Overton: I painted all of this corridor adjoining the various class rooms.

Mrs. Overton: This is the junior high library. This I painted. [9]

The Court: This open-air desk, we might call it, is in the original condition, is it?

Mrs. Overton: Yes.

The Court: Was there any exterior painting done when you took over the operation of the school?

Mrs. Overton: I painted practically the entire outside, not all in one year. There may be bits here, a wall here or there, that hadn't been, but I think, practically speaking, the whole outside of the building has been repainted.

The Court: I purposely came out on this deck because I figured the woodwork here would give one a better idea of the age and condition of the main structure.

Mrs. Overton: Yes. That has been painted every year. This balustrade around here is painted every year.

The Court: Mrs. Overton, do you recall when this part of the roof, I suppose you would call it, here was last painted?

Mrs. Overton: I know that we painted the whole front of the house in the summer of 1942 and whether that has been painted or touched up since I don't know, but I should think not.

The Court: You have how many class rooms facing the south side of the building on this second floor?

Mrs. Overton: This is the library and this is the [10] junior high office and that I redecorated and put up new hangings. This is Class Room 6, which I repainted.

The Court: Was this a bedroom?

Mrs. Overton: Yes.

The Court: And you installed blackboards, did you?

Mrs. Overton: Yes.

The Court: And chairs and desks?

Mrs. Overton: We bought some of these things but I can't tell you which ones.

Mrs. Overton: Room 7 is a class room. It was two bedrooms, which I threw together, and I put in the blackboards and painted it.

Mrs. Overton: This Room 8 in here was three bedrooms and a bath and closet, and I put in blackboards and redecorated and repainted it.

Mrs. Overton: This is the student council room. This is where the girls' council of the school government meets. This I papered and redecorated and this table is new.

Mrs. Overton: This is called my room. This is a room which I reserve if and when to change my clothes or sleep here. With the exception of this wicker chair and the small [11] table, the furniture is all new. This was repainted and the bathroom was repainted.

Mrs. Overton: This Room 15 was a bedroom which I repapered and repainted and it is now my secretary's office.

Mrs. Overton: This corridor I repainted also.

Mrs. Overton: This is a storage attic on the third floor, in the southeast corner of the building.

Mrs. Overton: We have on each side of the corridor servants' rooms. Some of these are now used as storage rooms for costumes.

Mrs. Overton: This is Room A. This is the general size of the rooms and general type of room.

The Court: These rooms originally were used for servants' quarters?



Mrs. Overton: Yes; and storage. I painted some of the rooms but I don't think I could tell you which ones. The ones we use I repainted and I had this corridor repainted.

The Court: This portion of the building gives you a better idea of its age?

Mrs. Overton: Yes, sir. [12]

The Court: What is this?

Mrs. Overton: It is a roof.

The Court: This little section of the roof looks out on the patio, northerly?

Mrs. Overton: It faces northerly; yes. It is only used for accommodation of guests.

The Court: It is ordinarily used only to accommodate guests—during what?

Mrs. Overton: During entertainments.

The Court: Are the south end and the east wing the only sections that have three stories?

Mrs. Overton: Yes, sir.

The Court: And this is all part of the original construction, is it?

Mrs. Overton: Yes. That building across the end there is the new auditorium building.

The Court: That is to say, the building we are looking at, at the northern end of the patio, is the gymnasium?

Mrs. Overton: No; what they call the auditorium or the music building.

Mr. Bryant: That is the auditorium that was built in 1928?

Mrs. Overton: Yes.

Mrs. Overton: This is Room 16, which is a sitting room [13] for the teachers who live in the house. They all live in this wing and some of the maids.

The Court: This is, in the east wing?

Mrs. Overton: Yes. This I completely refinished and redecorated.

The Court: This wing of the second floor?

Mrs. Overton: Yes.

Mrs. Overton: This is Room 17 which is a faculty bedroom. This furniture was here but I have redecorated it. That chair is new and the bed is new.

The Court: Generally speaking, would you care to make some comment as to what work was done with reference to the rooms on either side of this corridor?

Mrs. Overton: Yes; I repapered them and repainted, I think, all of them, and refurnished them. They had white painted furniture, old-fashioned. So I finished them with modern furniture. This room you can look in. This is more or less the pattern of the way we furnished them, referring to Room 27. This was repainted and repapered and redecorated.

Mrs. Overton: This is the sewing room and that painted dresser was the kind of thing that was in all of the bedrooms, with white iron beds. [14]

The Court: Would you say that is an Oregon pine dresser?

Mrs. Overton: It is a soft wood of some kind.

The Court: Very plain?

Mrs. Overton: Yes.

Mrs. Overton: This is the vocal music studio. I repainted all of this.

Mrs. Overton: This is the junior assembly room, which I repainted entirely. It had once been used as a

library, with book shelves all around, and I took those out and plastered it and painted it.

Mrs. Overton: This is the gymnasium and this is what I referred to as not being finished.

The Court: In other words, the east wall and the north wall and the upper portions of the south wall and the ceiling are not sealed?

Mrs. Overton: No.

The Court: In other words, the frame construction is exposed.

Mrs. Overton: Yes. This is a dressing room.

The Court: The dressing rooms adjoin the gymnasium to the west?

Mrs. Overton: Yes. [15]

The Court: Did you do any work here?

Mrs. Overton: We painted it, is all. I figured I couldn't begin it until I got all of it. The showers run along through there.

Mrs. Overton: The girls play on all of these fields and on the archery range there would be less than half of the senior high school at a time. Half of the senior high school have their sports from 2:00 to 3:00.

The Court: There is an open space immediately adjoining the gymnasium, to the north, which is used apparently for parking bicycles?

Mrs. Overton: Yes, and the turn-around for cars.

The Court: Then, adjoining that parking space to the north there are three practice volleyball courts?

Mrs. Overton: Yes; but that really isn't three volleyball courts. This I cut up into small ones. That is, strictly, one court. It is really one basketball court.

The Court: The three combined constituting a single basketball court?

Mrs. Overton: Yes. These are the three tennis courts north of the auditorium building. We keep this one tennis court for tennis now. Volleyball is so popular that we have turned everything into volleyball now. [16]

Mrs. Overton: We have the two combination volleyball and basketball courts on this side.

The Court: That is, on the west side adjoining the auditorium?

Mrs. Overton: Yes.

The Court: Is that your school bus?

Mrs. Overton: That is the school bus, which I am not interested in. They pick up the girls.

Mrs. Overton: This is the senior high assembly room. All of this I repainted.

The Court: Is it used as a study room?

Mrs. Overton: A study room and assembly room for the whole school. And then there is a stage here where they put on any little productions that they give.

The Court: Did you do any work here?

Mrs. Overton: We repainted this.

Mrs. Overton: And I repainted this corridor.

The Court: Is this the center of the auditorium building?

Mrs. Overton: It is the east side. The auditorium itself takes up most of the space.

The Court: On the east side of the auditorium building do you have some class rooms? [17]

Mrs. Overton: Yes; there are five and they are, roughly, like this one. All five of them I repainted. I replaced some desks and so on but I couldn't tell you which ones.

Mrs. Overton: There is a lavatory down below here, which is not important.

Mrs. Overton: We are now in the building called the music building.

The Court: How many stories?

Mrs. Overton: It is one story.

Mr. Bryant: This is part of the west wing of the main building, is it not?

Mrs. Overton: No; it isn't.

Mr. Bryant: When was this built?

Mrs. Overton: It was built at the same time as the other.

Mr. Bryant: Do we call this, for the purpose of the record, the old music building?

Mrs. Overton: Yes.

The Court: In other words, this is the original music building?

Mrs. Overton: Yes. The auditorium is strictly Caswell Hall.

The Court: Do you have a series of class rooms in this [18] old music building?

Mrs. Overton: We have this piano school. This whole building I repainted.

The Court: This is the room where I presume piano instructions are given?

Mrs. Overton: Yes.

Mrs. Overton: These two rooms, which I can't get in, I threw together. They are the supply and drug rooms. I did quite a little bit of carpentering there.

The Court: The room just mentioned is at the northwest corner of the original music building?



Mrs. Overton: Yes.

The Court: Are there other rooms in this building?

Mrs. Overton: Yes; practice rooms. That is where the a capella choir meets. This is the music department office, really.

The Court: Have any changes been made here?

Mrs. Overton: I built in these things and I painted it all. I would have put linoleum down if I could have gotten any. This is in very bad shape.

The Court: We are in the southwest section of the original music building, are we?

Mrs. Overton: Yes. [19]

The Court: This is on the east side of the original music building, is it?

Mrs. Overton: Yes, sir.

The Court: This is practically the same size as the room in the southeast corner, is it?

Mrs. Overton: Yes.

Mrs. Overton: We are now in the east wing.

The Court: And the north corner?

Mrs. Overton: The gymnasium is still north. We are south of the gymnasium.

The Court: And this particular room is called what?

Mrs. Overton: Room O. I also repainted it. This is used occasionally for a dressing room and is also used for textile work.

Mrs. Overton: This is the room where the sewing class meets. This I repainted.

Mrs. Overton: This is the domestic science kitchen. I have done practically nothing in here. This is the color

of almost everything. This is dark green and I don't think that has been painted; that is, the wood work has been painted but I don't think the walls have. [20]

Mrs. Overton: This is overall space for the actual kitchens, and this is the house manager's office, which I painted and put new hangings in, and I painted this servants' hall.

The Court: Would you call that the pantry there?

Mrs. Overton: Yes.

Mrs. Overton: This is the help's dining room, which I painted.

Mrs. Overton: This is the kitchen and this I painted and I don't think I have done anything else here.

Mrs. Overton: This is the bake shop.

The Court: Do you have any boarding students?

Mrs. Overton: We have 112 junior high girls for lunch and 45 teachers, besides the help. There are six or seven teachers who live in the house and there are 11 of the help to whom we serve breakfast and dinner. This is the main pantry and I painted this and put down new linoleum. This is where I should have the freezing unit.

The Court: In other words, you have an old-style ice box?

Mrs. Overton: Yes.

Mr. Bryant: An old-style walk-in space? [21]

Mrs. Overton: We have two dining rooms and these I painted and put new curtains on the doors and so forth.

Mr. Kumler: What about the drapes?

Mrs. Overton: The drapes were here. A lot of the carpets need replacing. They put them in in either 1940 or 1941. I haven't been able to buy a carpet since. This is the old carpet. A good many in the house are getting like it.

The Court: In other words, at the westerly exit to the westerly dining room the carpet shows the same to be very badly worn?

Mr. Bryant: How long has it been that way?

Mrs. Overton: Of course, I couldn't tell you absolutely but it was pretty bad when I took the place. As we made these new class rooms—there were carpeted bedrooms—we have been able to replace some of the carpets from the carpets in the bedrooms.

The Court: In the area that leads from one dining room to another the same condition of the carpet appears?

Mrs. Overton: Yes.

The Court: And this same worn condition also appears in other spots in the dining room?

Mrs. Overton: Yes.

Mr. Kumler: Mrs. Overton, can you tell the court how much this carpeting runs per square foot, the kind that you would buy? For this purpose you would buy it by the yard, [22] wouldn't you?

Mrs. Overton: By the square yard. It runs probably four and a half or five dollars. It just doesn't pay to get anything that doesn't wear. I don't know now what it would cost or whether you can get it at all.

Mr. Kumler: There is no way of telling how much there is of it.

The Court: I would think one could say that in normal times a carpet in this condition could at once be replaced.

Mr. Bryant: The nap seems to be worn off uniformly.

Mrs. Overton: This is the archery range on this lawn and the target is down there. I think you have seen it all.

Mr. Kumler: Will you tell the court about the carpets in this hall?

Mrs. Overton: This is the entrance hall or the main hall in this building, both the part that runs north and south and the part that runs east and west. That was carpeted in 1941 and I have the price of that because I asked Mrs. Marsden how much that came to. That came to \$1,050.

The Court: Do you think you could compute what it cost per yard?

Mrs. Overton: She put down for me 177 square yards at \$1,048.

The Court: If you have shown us everything, I think we [23] will be on our way.

Mrs. Overton: I think we have covered the entire ground.

The Court: Thank you very much.

Mrs. Overton: Not at all.

[Endorsed]: Filed March 2, 1948. [24]

[Title of District Court and Cause]

## STIPULATION NO. 1

It is hereby stipulated and agreed by and between the parties through their respective counsel that the Court may accept the following as facts in this proceeding subject to the right of either party to explain or amplify or to cross-examine in regard thereto:

1. That the plaintiff at all times material hereto was a California Corporation having its principal place of business at 735 Roosevelt Building, Los Angeles, California.

2. That all the taxes sought to be recovered in this proceeding were collected by Nat Rogan, Collector of Internal Revenue at Los Angeles, California, and that at the time this action was commenced, said Nat Rogan was no longer in office.

3. That the taxes sought to be recovered in this proceeding are surtaxes levied and collected from plaintiff under the provisions of Section 102, of the Revenue Act of 1938 and of the Internal Revenue Code respectively, for the plaintiff's taxable year ended August 31, 1939 and August 31, 1940, together with interest paid to defendant by reason of the asserted late payment of said taxes.

4. That on or before the time required by law, plaintiff filed its income tax return on form 1120 as follows:

For the year ended	Showing net taxable income of	Showing income tax liabilities of
August 31, 1939	\$37,337.55	\$6,279.36
August 31, 1940	\$21,870.32	\$2,535.91

and that neither the amount of the net income nor the income tax liability shown in said returns is in dispute in this proceeding.



(Stipulation No. 1)

5. That by letter dated July 7, 1942, the Commissioner of Internal Revenue acting for and on behalf of defendant asserted deficiencies in Federal income taxes against the plaintiff as follows:

For the year ended	Income taxes under Section 13	Surtaxes under Section 102*	Total deficiency for the year
August 31, 1939	None	\$3,389.55	\$3,389.55
August 31, 1940	\$924.46	\$5,112.03	\$6,036.49

together with interest for the late payment of said taxes according to law.

6. That on July 31, 1942, plaintiff paid to Nat Rogan Collector of Internal Revenue at Los Angeles the entire amount of the deficiencies asserted by the defendant (as set forth in paragraph 5 above) plus interest for the late payment of said deficiencies as follows:

For the year ended	Income taxes under Section 13	Surtaxes under Section 102	Interest on deficiency for the year
August 31, 1939	None	\$3,389.55	\$551.24
August 31, 1940	\$924.46	\$5,112.03	\$619.52

and that interest of \$1.67 and \$2.98 respectively were overpaid by plaintiff for the two years.

7. That of the taxes and interest paid, as set forth in paragraph 6 above, only the surtaxes paid for each of the two years under Section 102 of the law, together with the interest paid thereon, are in controversy in this proceeding, plaintiff having abandoned its claim with respect to the income taxes under Section 13, in the amount of \$924.46 together with the interest paid thereon.

8. That on August 7, 1943, and within two years of the date of payment of the deficiencies in Federal income

\*For the year ended August 31, 1939 under the 1938 Revenue Act; for the year ended August 31, 1940 under the Internal Revenue Code.

(Stipulation No. 1)

and surtaxes hereinabove described, plaintiff filed its claims for refund on form 843 for the taxable years ended August 31, 1939 and August 31, 1940, true copies of which are attached to the plaintiff's complaint in this proceeding and marked "Exhibit 1" and "Exhibit 2" respectively; that each of said claims set forth, under oath, the grounds for refund relied upon in this proceeding and facts describing, in detail, the factual bases of the claims; that on November 5, 1943, the Commissioner of Internal Revenue mailed, by registered mail, his notices of disallowance of said claims, excepting however that the Commissioner determined over-assessments of \$41.98 and \$85.75, respectively, for the years ended August 31, 1939 and August 31, 1940 due to the exclusion from plaintiff's gross income of certain nontaxable bond interest erroneously reported in its returns for said years, and that, except for the over-assessments of \$41.98 and \$85.75, defendant has and still does refuse to refund or repay all or any part of such taxes.

9. That plaintiff corporation was not formed for the purpose of preventing the imposition of surtaxes upon its shareholders.

10. That if regularly introduced in evidence plaintiff's books and records would show, in statement form, its financial condition, at the close of each of its taxable years ended August 31, 1931 to August 31, 1940, both inclusive, as shown in the Comparative Balance Sheet set forth in Exhibit A hereto attached.

11. That if regularly introduced in evidence plaintiff's books and records would show, in statement form, its business operations for each of its taxable years ended August 31, 1934 to August 31, 1940, both inclusive, as

(Stipulation No. 1)

shown in the Comparative Profit and Loss Statements set forth in Exhibit B hereto attached.

12. That if regularly introduced in evidence plaintiff's books and records would show, in statement form, the analysis of its surplus account for the period from August 31, 1933 to August 31, 1940 as set forth in Exhibit C hereto attached.

13. That as of August 31, 1939 and August 31, 1940, the fair market values of the stocks and bonds shown in plaintiff's balance sheets, as set forth in Exhibit A, hereto attached were \$108,245.00 and \$114,125.00 respectively, determined in accordance with the market prices thereof on each of said days.

14. That if called upon to do so, Mr. Eugene Overton would testify that during the period from July 1, 1915 to August 31, 1940, both inclusive, plaintiff corporation borrowed money in the amounts and for the purposes set forth in said Eugene Overton's affidavit hereto attached and market Exhibit D.

15. The pertinent portion of the deed covering the land upon which plaintiff's main school buildings are situated contains the following restrictions:

"This conveyance is made upon and subject to the following conditions of subsequence, all of which shall also be treated as covenants running with the land, and all of which the grantee assumes and agrees to perform and abide by, and hereby expressly makes binding upon its heirs, successors and assigns, viz;

"1st. That there shall be erected upon said premises and completed not later than one year from the date

(Stipulation No. 1)

hereof a school building in substantial conformity with plans and specifications therefor attached to a contract to be entered into by and between the Grantee herein as owner and one Fred W. Siegel, as contractor, which said contract, plans and specifications will be filed for record in the office of the County Recorder of Los Angeles County, to which said plans and specifications reference is hereby made for further particulars.

“2nd. That from and after the date for the completion of the building mentioned in the preceding subdivi-

[1st]

sion 6th, there shall be conducted upon the premises hereby conveyed for the period of at least ten years a first class school for girls; and that during such period the premises shall not, nor shall any part thereof, be used for any other purpose. But such school use may include the application of part of the grounds to athletic and other uses kindred and accessory to school uses.

“3rd. That except as provided in the two preceding conditions numbered 1st and 2nd, said property shall be used for residence purposes only and the term ‘residence purposes’ shall not include, but is distinctly understood to exclude, a use for an apartment house, hotel, flat, sanitorium or hospital, each and all of such uses being distinctly prohibited. But the term ‘residence purposes’ shall include a use of a portion of the premises for a private garage or other ordinary outbuilding for use for domestic purposes by an occupant of a residence on the property; and shall also include the right of the occupant to keep thereon livestock and fowls in small quantities for the personal domestic uses of the occupant.



(Stipulation No. 1)

"4th. \* \* \*.

"5th. \* \* \*.

"6th. \* \* \*.

"7th. That no structure shall be placed upon such premises and occupied as residence at any time prior to the erection of the main residence upon the portion of the property upon which such other buildings have been or may be placed. And that any residence placed on said property shall at such time cost and be reasonably worth at least \$5,000.00.

"8th. That the Grantee shall perform the obligations hereinbefore imposed upon it with respect to street work to be done by it.

"It is provided however that the Grantee may at any time in the future pay to the grantor the sum of \$6,000.00 in gold coin of the United States together with interest thereon at the rate of 7% per annum from the date hereof to the date of payment and upon such payment the Grantor shall execute to the Grantee a release of the conditions and covenants contained in the subdivision numbered 2nd ante requiring the maintenance of a school on said property.

"And it is provided further that all of said conditions and covenants shall terminate and be of no effect after January 1, 1950; but any forfeiture for a breach occurring prior to such date shall be absolute.

"It is provided that as to the Grantee, its successors and assigns, the breach of any of the foregoing conditions and covenants shall cause such premises, together with the appurtenances, to be forfeited to and revert to the Grantor, his heirs, successors or assigns, each of whom shall have



(Stipulation No. 1)

the right of immediate entry upon such premises in the event of such breach. But the breach of any of the foregoing conditions and covenants by the owner of such property, or anyone in possession thereof under him, and any forfeiture or re-entry by reason of such breach, shall not operate to defeat or effect the lien of any mortgage or deed of trust made in good faith, and for value upon such property or any part thereof; provided however, that each, every and all of the foregoing conditions, and covenants shall at all times remain in full force and effect as against anyone requiring any title to such premises by a foreclosure or a sale under any such deed of trust or mortgage, and as against the holder of any such title a forfeiture may be enforced and a re-entry may be had for any breach by him of any of the covenants or conditions herein imposed upon or herein assumed by the Grantee, to the same extent as though the holder of such title had been the original Grantee herein named. And provided further that the breach of any of such conditions by anyone may be enjoined, abated or remedied by appropriate proceedings brought by Grantor, his successors or assigns, notwithstanding any condition of the title or liens thereon; but such rights are cumulative and the exercise thereof shall in no way effect the right of the Grantor to exercise his rights of forfeiture and re-entry where herein provided for."

16. Eugene and Georgia Overton each owned one-half of plaintiff's stock during the taxable years.

Dated: September 18, 1945.

\* \* \* \* \*

## EXHIBIT "A"

Page One

Regulation No. 1)

RLBOROUGH CORPORATION  
COMPARATIVE BALANCE SHEETS

SETS:	(per books)									
	8-31-1931	8-31-1932	8-31-1933	8-31-1934	8-31-1935	8-31-1936	8-31-1937	8-31-1938	8-31-1939	8-31-1940
School Property										
Land & Improvements	36,368.07	36,368.07	36,368.07	36,368.07	36,368.07	36,368.07	36,368.07	36,368.07	36,368.07	36,368.07
School Bldgs.	95,178.17	95,178.17	95,178.17	95,178.17	95,178.17	95,178.17	95,178.17	95,178.17	95,178.17	95,178.17
Auditorium & Fixtures	80,169.70	80,169.70	80,169.70	80,169.70	80,169.70	80,169.70	80,169.70	80,169.70	80,169.70	80,169.70
Plant & Machinery	3,808.53	4,034.53	4,034.53	4,034.53	4,034.53	4,034.53	4,034.53	4,034.53	4,034.53	4,034.53
Tennis Courts & Sprinklers	6,615.38	6,615.38	6,615.38	6,615.38	6,615.38	6,615.38	6,615.38	6,615.38	6,615.38	6,615.38
Auto	2,404.90	2,404.90	2,404.90	2,404.90	2,034.63	2,034.63	2,034.63	2,034.63	2,034.63	2,034.63
Linen, Dishes, Silver, etc.	2,818.33	2,818.33	2,818.33	2,818.33	2,818.33	2,818.33	2,818.33	2,818.33	2,818.33	2,818.33
Depreciation	(69,836.80)	(78,561.92)	(86,735.96)	(94,106.23)	(99,673.84)	(148,870.29)	(157,601.18)	(165,861.06)	(173,285.21)	(180,582.31)
Furn. & Fixt. (less depr.)	12,761.99	11,751.26	10,400.94	9,177.94	8,078.23	Gr. 37,124.00	37,686.08	38,337.47	38,551.71	38,687.47
Carpets ( " " )	668.76	445.84	297.23	198.15	132.10	" 11,319.71	11,319.71	11,319.71	11,319.71	11,319.71
Investments										
Stocks & Bonds—Listed	58,678.75	69,928.75	58,747.55	42,686.55	61,514.22)	78,543.40)	109,294.06	(S 92,444.59	146,493.36	157,093.29
" —Unlisted	19,712.50	19,712.50	19,712.50	19,712.50	9,700.00)	" )		(B 27,492.54		
Real Estate	35,292.59	35,292.59	35,292.59	35,292.59	35,292.59	35,792.59	950.78	950.78	950.78	950.78
Note—Wm. C. DeMille Prod. Inc.	—0—	—0—	5,000.00	5,000.00	5,225.00					
Decl. of Trust 1/3						1,000.00	1,000.00			
Note Rec.						2M 200.00				
Other Assets										
Note Receivable	5,000.00	5,000.00					7,323.04	7,250.00	7,250.00	
Ada S. Blake, Lessee	9,716.45	—0—				573.53	1,765.11	5,901.07	7,682.77	
Accrued Interest Receivable	75.00	243.75	331.25	67.50	67.50	95.00	152.71	798.12	1,223.13	805.50
Cash	868.19	11,721.53	3,587.14	6,690.08	4,932.74	8,018.25	15,682.38	30,277.32	19,417.09	39,679.84
Accounts Rec.					844.01	336.48	5,524.61		95.84	8,463.08
Trustee A/C									13.11	
Deferred Charges										
Unexpired Taxes	375.00	450.00	468.34	466.83	600.00	250.00				
" Insurance	144.90	31.50	258.30	144.90	31.50	250.46	143.13	35.80	118.66	170.91
Mark Overton	—0—	—0—	—0—	14.00						
	<u>\$300,820.41</u>	<u>\$303,604.88</u>	<u>\$274,948.96</u>	<u>\$252,933.89</u>	<u>\$253,962.86</u>	<u>\$251,851.94</u>	<u>\$260,459.24</u>	<u>\$276,165.15</u>	<u>\$287,049.76</u>	<u>\$303,807.08</u>



(Supplement No. 1)

## EXHIBIT "A"

Page Two

MARLBOROUGH CORPORATION  
COMPARATIVE BALANCE SHEETS

LIABILITIES AND CAPITAL:—	(per books)									
	<u>8-31-1931</u>	<u>8-31-1932</u>	<u>8-31-1933</u>	<u>8-31-1934</u>	<u>8-31-1935</u>	<u>8-31-1936</u>	<u>8-31-1937</u>	<u>8-31-1938</u>	<u>8-31-1939</u>	<u>8-31-1940</u>
Capital Stock	50,000.00	50,000.00	50,000.00	50,000.00	50,000.00	50,000.00	50,000.00	50,000.00	50,000.00	50,000.00
due 1-21-31										
Mortgage Payable—Auditorium	50,000.00	40,000.00	30,000.00	—0—						
Notes Payable										
Georgia Overton	14,000.00	14,000.00	14,000.00	14,000.00	14,000.00	14,000.00	14,000.00	14,000.00	14,000.00	14,000.00
Eugene Overton	6,500.00	6,500.00	6,500.00	6,500.00	6,500.00	6,500.00	6,500.00	6,500.00	6,500.00	6,500.00
Mark Overton	14,986.00	14,986.00	14,986.00	15,000.00	15,000.00	15,000.00	15,000.00	15,000.00	15,000.00	15,000.00
Accounts Payable	—0—	—0—	2,829.74							
Accrued Interest & Taxes Payable	1,499.32	1,288.87		1,542.42	1,855.35	Int. 414.16	414.16	414.16	414.16	414.16
" Prop. Tax						Tax 300.00				
" Salary						100.00	100.00	100.00	100.00	100.00
Street Improvement Bonds Payable	1,449.47	1,242.40				414.12	207.05			
Ada S. Blake, Lessee	—0—	2,123.92	1,960.17	850.28	961.60					
Federal Income Tax	2,990.78	1,738.08		1,500.00	1,800.00	1,300.00	6,000.00	7,700.00	6,300.00	3,700.00
" " "		513.27	513.27							
Capital Stock Tax—accrued	—0—	—0—	232.00	260.00		351.00	360.00	722.00	391.00	460.00
Excess Profits Tax				465.05						
Surplus	159,394.84	171,212.34	153,927.78	162,816.14	163,845.91	163,472.66	167,878.03	181,728.99	194,344.60	213,632.92
	<u>\$300,820.41</u>	<u>\$303,604.88</u>	<u>\$274,948.96</u>	<u>\$252,933.89</u>	<u>\$253,962.86</u>	<u>\$251,851.94</u>	<u>\$260,459.24</u>	<u>\$276,165.15</u>	<u>\$287,049.76</u>	<u>\$303,807.08</u>





United States of America

Population No. 1)

EXHIBIT "B"

MARLBOROUGH CORPORATION

COMPARATIVE PROFIT AND LOSS STATEMENTS (per books)

Fiscal years ending Aug. 31	1934	1935	1936	1937	1938	1939	1940
INCOME							
School—Rental	\$21,254.61	\$21,254.61	\$26,127.75	\$30,413.58	\$30,413.58	\$30,413.58	\$30,413.58
" —Share	644.84	898.57	558.35	1,765.11	5,933.08	7,682.77	—0—
" —Capit. Addn.s	102.32	1,750.70	50.47	562.08	651.39	214.24	135.76
" —Paid by Lessee	207.07	207.07	207.07	207.07	207.05	—0—	
Interest—Bonds	760.63	135.00	222.88	232.75	424.11	2,098.00	2,762.58
—Notes Rec.	75.00	225.00		102.71	435.00	435.00	307.00
Dividends	620.00	1,074.25	2,070.11	4,280.50	3,925.90	2,956.63	4,141.00
Profit on Sale of Invest.	518.75			7,964.30		4,759.52	775.39
" " " " Auto		334.63					
Pimlico Tennis Courts				642.16			
Gain—Liquidation of Trust					3,738.67		
Miscellaneous						18.08	16.70
	<u>24,183.22</u>	<u>25,879.83</u>	<u>29,236.63</u>	<u>46,170.26</u>	<u>45,728.78</u>	<u>48,577.82</u>	<u>38,552.01</u>
EXPENSES:—							
Interest	3,751.53	2,486.21	2,514.81	2,485.00	2,497.82	2,583.74	2,508.51
Taxes—general	567.14	834.68	1,418.69	548.20	920.34	1,326.35	2,310.47
Insurance	113.40	113.40	103.02	107.33	107.33		
Depreciation	8,774.61	9,188.97	9,013.54	8,730.89	8,259.88	7,424.15	7,297.10
Miscellaneous	609.04	488.72	1,214.43	782.70	618.03	784.02	968.25
Income Tax Provision	1,479.14	1,592.40	1,174.97	5,818.18	7,241.32	6,343.95	3,679.36
School—share for 1934		644.84					
Loss on Sale of Investments		9,500.84	10,095.42		6,733.10		
" " Cancel. Notes Rec.			2,825.00				
" " Sale Real Estate				20,792.59			
	<u>15,294.86</u>	<u>24,850.06</u>	<u>28,359.88</u>	<u>39,264.89</u>	<u>26,377.82</u>	<u>18,462.21</u>	<u>16,763.69</u>
NET INCOME	<u>\$ 8,888.36</u>	<u>\$ 1,029.77</u>	<u>\$ 876.75</u>	<u>\$ 6,905.37</u>	<u>\$19,350.96</u>	<u>\$30,115.61</u>	<u>\$21,788.32</u>



(Stipulation No. 1)

EXHIBIT "C"

MARLBOROUGH CORPORATION V. U. S.

No. 3727 -H- Civil

Analysis of Surplus—(per books)

<u>Date</u>	<u>Item</u>	<u>Debit</u>	<u>Credit</u>	<u>Balance</u>
8-31-1933	Balance			\$153,927.78
8-31-1934	Profit & Loss		\$ 888.36	162,816.14
8-31-1935	Profit & Loss		1,029.77	163,845.91
8-31-1936	Profit & Loss		876.75	
	Dividends	\$ 1,250.00		163,472.66
8-31-1937	Profit & Loss		6,905.37	
	Dividends	2,500.00		167,878.03
8-31-1938	Profit & Loss		19,350.96	
	Dividends	5,500.00		181,728.99
8-31-1939	Profit & Loss		30,115.61	
	Dividends	17,500.00		194,344.60
8-31-1940	Profit & Loss		21,788.32	
	Dividends	2,500.00		213,632.92

Exhibit "D"

AFFIDAVIT

State of California     )  
   ) ss.  
 County of Los Angeles )

Eugene Overton, being first duly sworn, deposes and says:

That he is, and during the years 1939 and 1940 was, a shareholder, officer and director of the Marlborough Corporation, plaintiff in this proceeding.

That during the period from and after January 1, 1915, to and including August 31, 1940, the plaintiff, Marlborough Corporation, borrowed the following sums from

(Stipulation No. 1)

the persons and for the purposes hereinbelow set forth, viz:

1. That on or about July 6, 1915, plaintiff became indebted to G. Allan Hancock, upon a note covering the purchase price of land, constituting the major part of the present site of plaintiff's school at 3rd and Rossmore Streets in Los Angeles, in the amount of \$14,000. This indebtedness was guaranteed by Eugene Overton.

2. That on or about September 4, 1915, plaintiff became indebted to F. W. Siegel, a contractor, upon a note and mortgage covering part of the cost of construction of plaintiff's main school building in the amount of \$32,500.

3. That on or about May 27, 1916, plaintiff borrowed the sum of \$52,500 from the Bond Investment Company of Los Angeles, to provide for unexpected additional costs incurred in erecting the plaintiff's main school building. At Eugene Overton's request, a part of this loan was guaranteed personally by G. Allan Hancock.

4. That on or about June 24, 1916, plaintiff became indebted to Mr. John C. Austin on two notes totalling \$1,680 covering architect's fees on the new main school building erected in that year.

5. That on or about September 22, 1922, plaintiff borrowed the sum of \$40,000 from the Mortgage Guarantee Company of Los Angeles, to refinance the loan of \$52,500 previously made from the Bond Investment Company on May 27, 1916.

6. That on or about June 22, 1925, plaintiff became indebted to Georgia Overton, its stockholder, in the sum

(Stipulation No. 1)

of \$7,000 covering the purchase price of a 47 foot strip of land adjoining the school grounds.

7. That on or about October 26, 1925, plaintiff borrowed from Eugene and Georgia Overton, its sole shareholders, the sum of \$40,000 which was used to pay off the loan from the Mortgage Guarantee Company made on September 22, 1922.

8. That on or about May 16, 1927, plaintiff borrowed the sum of \$60,000 from the Farmers & Merchants Bank of Los Angeles, to cover the cost of a new auditorium and classroom building erected on the premises in that year.

9. On or about June 21, 1928, plaintiff borrowed the sum of \$65,000 from the Spalding Company of Los Angeles for the purpose of refinancing the loan made on May 16, 1927, from the Farmers & Merchants Bank.

10. That of the total borrowings enumerated hereinabove, \$140,000 thereof was used for the purpose of refinancing prior loans, leaving a net amount borrowed for the period of \$172,680.

Eugene Overton

Subscribed and sworn to before me this 18th day of September, 1945.

(Seal)

M. De Viney

Notary Public in and for said County and State

My Commission Expires March 10, 1947.

[Endorsed]: Filed Sep. 18, 1945.



[Title of District Court and Cause]

STIPULATION NO. 2

It is hereby stipulated by and between the parties, through their respective counsel, that the Court may accept the following as facts in this proceeding, subject to the right of either party to explain, amplify, or cross-examine in regard thereto:

1. That if the plaintiff's auditors during the taxable years in question, Price, Waterhouse & Company, were called upon to testify regarding the property and depreciation accounts of the plaintiff corporation, they would testify that the costs of the plaintiff's depreciable properties and the depreciation sustained thereon (adjusted to income tax bases) as of the end of the taxable years ended August 31, 1939, and August 31, 1940, were as follows:

(Stipulation No. 2)

MARLBOROUGH SCHOOL

Schedule of Depreciable Assets and Accumulated  
Depreciation as at August 31, 1939, and  
August 31, 1940

<u>Asset</u>	<u>Age Years</u>	<u>Book Value 8/31/40</u>	<u>Accumulated Depreciation 8/31/39</u>	<u>Accumulated Depreciation 8/31/40</u>	<u>Net Book Value 8/31/40</u>
(After income tax adjust.)					
Frame School					
Buildings	24	\$ 95,178.17	\$ 71,565.22	\$ 74,737.82	\$ 20,440.35
Auditorium	13	74,916.87	26,833.62	28,706.54	46,210.33
Auditorium Fixtures	13	5,252.83	5,252.83	5,252.83	—0—
Plant and Machinery		4,034.33	4,034.33	4,034.33	—0—
Tennis Courts		5,165.38	5,165.38	5,165.38	—0—
Sprinkler System		1,450.00	1,450.00	1,450.00	—0—
Auto		2,034.63	2,034.63	2,034.63	—0—
Linen Silver, Dishes		2,818.33		1,055.45	1,762.88
*Furniture and Fixtures		38,687.47	33,899.35	35,210.11	3,477.36
Rugs		11,319.71	11,319.71	11,319.71	—0—
Totals		<u>\$240,857.72</u>	<u>\$161,555.07</u>	<u>\$168,966.80</u>	<u>\$ 71,890.92</u>

\*Only book value figure different as at August 31, 1939, was Furniture and Fixtures which was \$38,551.71 at that date. For all practical purposes, therefore, the book values as at August 31, 1939, were the same as at August 31, 1940.

2. That if regularly introduced in evidence, plaintiff's books of enrollment would disclose that the relative geographical locations of the residences of the school's day students were as follows:

(Stipulation No. 2)

## MARLBOROUGH POPULATION TREND

Day Students

<u>School Year</u>	<u>East</u>	<u>West</u>	<u>Total</u>	<u>Percent of Total</u>	
				<u>East</u>	<u>West</u>
1923-24	260	74	334	77.8	22.2
1924-25	265	80	345	76.8	23.2
1925-26	143	69	212	67.4	32.6
1926-27	174	85	259	67.1	32.9
1927-28	306	168	474	64.5	35.5
1928-29	145	96	241	60.1	39.9
1929-30	170	140	310	54.8	45.2
1930-31	100	100	200	50.0	50.0
1931-32	95	78	173	54.9	45.1
1932-33	83	76	159	52.2	47.8
1933-34	73	87	160	45.6	54.4
1934-35	82	77	159	51.5	48.5
1935-36	82	97	179	45.8	54.2
1936-37	86	106	192	44.8	55.2
1937-38	88	128	216	40.7	59.3
1938-39	88	159	247	35.6	64.4
1939-40	79	149	228	34.6	65.4
1940-41	74	143	217	34.1	65.9
1941-42	70	128	198	35.3	64.7
1942-43	59	117	176	33.5	66.5
1943-44	77	168	245	31.4	68.6
1944-45	81	224	305	26.5	73.5

\* \* \* \* \*

4. That after making all undisputed adjustments to its taxable net income for the years ended August 31, 1939, and August 31, 1940, plaintiff's net statutory taxable incomes for each of said years, after the federal income taxes except those under Section 102 here involved, were \$30,971.56 and \$22,829.13 respectively.

Dated: September 24, 1945.

\* \* \* \* \*

[Endorsed]: Filed Sep. 24, 1945.

[Title of District Court and Cause]

### STIPULATION NO. 3

It is hereby stipulated and agreed by and between the parties through their respective counsel that the Court may accept the following as facts in this proceeding subject to the right of either party to explain or amplify or to cross-examine in regard thereto:

#### I.

That the original capital investment in plaintiff corporation was the sum of \$50,000.00.

#### II.

That the surplus per plaintiff's books for the taxable years in question was:

August 31, 1939	. . . .	\$194,344.60
August 31, 1940	. . . .	\$213,632.92

#### III.

That the alleged overpayments of \$1.67 and \$2.98 for the taxable years ending August 31, 1939, and August 31, 1940, respectively, were transferred to other accounts and that the same are stated by the Collector of Internal Revenue to be scheduled for refund shortly. That said payments are not therefore in controversy in this action and are not to be included as a part of any judgment entered into herein.

#### IV.

That the accumulations of plaintiff prevented the imposition of surtax upon plaintiff's shareholders in the sum of \$2,402.99 for 1939 and \$4,199.68 for 1940.

(Stipulation No. 3)

V.

That attached hereto marked "Exhibit A" is the lease executed by plaintiff as lessor and Ada Blake as lessee under which lease the school was operated during the taxable years ending August 31, 1939, and August 31, 1940.

Dated: September 25, 1945.

\* \* \* \* \*

Exhibit A

LEASE

This Lease and Agreement entered into as of September 1st, 1935, between Marlborough Corporation, a California corporation, Lessor, party of the first part, and Ada S. Blake, Lessee, of the City of Los Angeles, California, party of the second part.

The situation as to which the parties are contracting is as follows:

The Lessee since September 1st, 1925 has been in possession of and operating as Lessee the property hereinafter described as a girls' school, under the terms and conditions of a certain lease between Lessor and Lessee entered into June 23rd, 1925 and agreements supplemental thereto, and Lessee under the terms thereof has elected to renew said Lease for the period commencing September 1st, 1935 and ending August 31st, 1942, under the terms and conditions hereinafter set forth. Therefore, the parties do agree as follows:

I.

The Lessor hereby leases to the Lessee all of the real property situate in the City of Los Angeles, State of



(Stipulation No. 3)

California, and being the property now occupied by the Marlborough School, described as follows, to-wit:

\* \* \* \* \*

Together with all furnishings and fittings now on said premises belonging to the Lessor, for the sole purpose of conducting, and the Lessee hereby agrees, during the term of this lease, to conduct on said premises and with the property hereby leased, a school for girls in the same general manner and with the same high standards and policies as said school is now being, and has for many years last past been, conducted. In the conduct of said school, the Lessee shall have the right to, and shall, use the name of "Marlborough School" or "Marlborough School for Girls." No changes in the fundamental policy or policies followed for the last preceding ten (10) years in the conduct of said school shall be made by the Lessee, unless she first obtains the written consent of the Lessor thereto.

## II.

### TERM OF LEASE

The term for which this lease is to continue is seven (7) years, beginning as of September 1st, 1935 and ending August 31st, 1942.

## III.

### TAXES, REPAIRS AND UPKEEP

During the term of this lease the Lessee shall pay all state, county, municipal and federal taxes levied and assessed against the property hereby leased, at least ten (10) days before the same become delinquent. Should the Lessee fail to pay any such taxes at least ten (10) days

(Stipulation No. 3)

before the same become delinquent, the Lessor shall have the right, at its option, to pay at any time such taxes, together with any penalties that may have attached thereto, and the amount so paid, together with interest thereon at the rate of seven per cent (7%) per annum from the date of payment until repaid by the Lessee, shall immediately become due and payable from the Lessee to the Lessor. In the event any special assessment or assessments for local improvement are levied by any governmental or lawful authority against the leased property during the term hereof, Lessee will, in the year in which any such assessment shall become due and payable and in each succeeding year of the term hereof, pay to the Lessor one-tenth of the total amount of such assessment, including the interest thereon, if any. Such payment by the Lessee shall be made upon receipt of a statement from the Lessor of the amount thereof.

The Lessee shall, during the term of this lease, keep the property hereby leased, including lawns, garden, furnishings and fittings in at least as good repair, order and condition as the same are at the time of the commencement of this lease, and renew worn out furnishings and fittings as may be necessary to maintain the standard next referred to, it being particularly understood and agreed that one of the important elements making for success in the conduct of said school is that the grounds, buildings, furnishings and fittings shall always be in first-class order and condition, and in a high state of repair and efficiency, and that the same shall at all times be kept by Lessee in at least as good condition as they are at the time of the commencement of this lease, excepting as herein otherwise provided in Paragraph XI, in the event

(Stipulation No. 3)

of damage by fire, earthquake, et cetera. All renewals or additions to the furnishings, fittings and paraphernalia of the school, the cost of which shall have been charged as one of the school expenses, shall become the property of the Lessor, subject to this lease. Wherever in this lease the words "furnishings and fittings" occur, it shall be understood to include also books, appliances, apparatus and equipment, unless the context clearly expresses a contrary intent.

#### IV. RENT

The Lessee agrees to pay as rental for the property hereby leased, and for the use of the name and benefit of the goodwill, on November 15th, 1935 the sum of Seven Thousand Six Hundred Three and  $39/100$  Dollars (\$7,603.39), receipt whereof is hereby acknowledged, and on February 15th, 1936 the sum of Seven Thousand Six Hundred Three and  $39/100$  Dollars (\$7,603.39), and on April 15th, 1936 the sum of Three Thousand Three Hundred Seventeen and  $56/100$  Dollars (\$3,317.56), and on June 15th, 1936 the sum of Seven Thousand Six Hundred Three and  $41/100$  Dollars (\$7,603.41), which shall be the rent from September 1st, 1935 to and including August 31st, 1936. Thereafter, during the term of this lease, the Lessee agrees to pay as rental for the said property, and for the use of the name and benefit of the goodwill, the sum of Thirty Thousand Four Hundred Thirteen and  $58/100$  Dollars (\$30,413.58) per year, payable as follows:

Seven Thousand Six Hundred Three and  $39/100$  Dollars (\$7,603.39) on November 15th of each year, which

(Stipulation No. 3)

shall be the rent from September 1st to December 1st of each year; Seven Thousand Six Hundred Three and 39/100 Dollars (\$7,603.39) on February 15th of each year, which shall be the rent from December 1st to March 1st of each year; Seven Thousand Six Hundred Three and 39/100 Dollars (\$7,603.39) on April 15th of each year, which shall be the rent from March 1st to June 1st of each year; and Seven Thousand Six Hundred Three and 41/100 Dollars (\$7,603.41) on June 15th, which shall be the rent from June 1st to September 1st of each year.

## V.

### ACCOUNTS—DETERMINATION AND DIVISION OF NET PROFITS

All money received by the Lessee in connection with the conduct of the school shall, at all times during the term of this lease, be deposited by her in a bank in the City of Los Angeles, in a separate account in which no other funds shall be deposited, and all disbursements for school expenses shall be paid by check against said account, except petty cash expenditures. Said account is sometimes hereinafter referred to as the "school account."

The school fiscal year shall be from September 1st to August 31st, and it shall be divided into two "periods," the first "period" being from September 1st to March 31st and the second "period" from April 1st to August 31st. During the term of this lease, the Lessee agrees to keep full, true and accurate books and accounts, and the keeping of such accounts shall be at all times under the general supervision and direction of the firm of Price, Waterhouse and Company, certified public accountants, and the



(Stipulation No. 3)

Lessor shall have the privilege at all times of obtaining through said accountants any information it desires from said books and accounts. Immediately after the expiration of each "period" above specified, the Lessee shall have the said books and accounts audited by such accountants and have them prepare and furnish to the Lessor a report of such audit.

The net profits shall be determined in the same general manner as heretofore determined by the audits made by Price, Waterhouse and Company; provided, however, that in determining said net profits, no reserve for depreciation shall be deducted from the gross income, and the following items shall be included as expenses of conducting the school, namely: The cost of supervision and audits by the said accountants, the cost of permanent improvements, taxes and assessments paid by the Lessee as herein provided, the rental required to be paid by the terms of this lease, cost of repairs, upkeep and renewals and additions to furnishings and fittings, the cost of insurance, and all other items of expense (except income taxes) set forth in the profit and loss accounts prepared by Price, Waterhouse and Company in their audits made during the year ending August 31st, 1934, and such other items as elsewhere in this lease it is provided shall be included as items of expense of conducting the school; and provided that the salary of the Lessee as principal of the school shall not be charged at more than Ten Thousand and 00/100 Dollars (\$10,000.00) per annum.

Immediately after the determination each year by the auditors, by the audit which shall be made immediately after August 31st of each year, of the net profits for the



(Stipulation No. 3)

last preceding fiscal year, the Lessee shall pay to the Lessor fifty per cent (50%) of the net profits for such fiscal year and fifty per cent (50%) thereof may be taken and retained by the Lessee; provided, however, that in the event any profits shall be derived from the conduct of said school for the fiscal year ending August 31st, 1936, the Lessee may take and retain thereof not exceeding Four Thousand Two Hundred Eighty-five and 83/100 Dollars (\$4,285.83), free of any claim or interest of the Lessor, and any profits for said fiscal year in excess of said sum shall be divided equally between Lessor and Lessee. If the Lessee shall take and retain from the net profits for said fiscal year all or any part of said sum of Four Thousand Two Hundred Eighty-five and 83/100 Dollars (\$4,485.83), the amount so taken and retained shall be repaid by Lessee into the school account, to be held and used as working capital. Out of any net profits derived from the conduct of said school and taken and retained by Lessee, Lessee shall from time to time repay into the school account as working capital additional sums until said working capital shall amount to the sum of Ten Thousand Dollars (\$10,000.). If after said working capital amounts to Ten Thousand Dollars (\$10,000.) it is depleted, in the operation of said school, below the said amount, Lessee will, out of profits thereafter arising and taken and retained by Lessee, restore said working capital to the amount of Ten Thousand Dollars (\$10,000.). Lessee may at her option invest and reinvest any portion of said working capital, in excess of Five Thousand Dollars (\$5,000.), in readily marketable securities, and Lessor shall not share in or be charged with any profit or loss arising from so investing said working

(Stipulation No. 3)

capital, nor shall such profit and loss be treated as a profit or loss from school operations.

Should Price, Waterhouse and Company, or any other accountants who may hereafter be employed, be unable or unwilling at any time to make any such audit or to supervise the keeping of said books and accounts, the Lessor shall have the right to appoint any other certified public accountant, or firm of public accountants, doing business in the City of Los Angeles to make said audits and to supervise the keeping of the books and accounts, and the references in this lease to Price, Waterhouse and Company shall then apply to such other auditors.

## VI.

### SCHOOL PRINCIPAL—ASSIGNMENT OF LEASE—VICE PRINCIPAL

It is particularly understood and agreed that this lease is given by the Lessor solely because of the fact that the directors of the Lessor have confidence in the ability of the Lessee to personally conduct the school in the manner that it should be conducted and has been conducted in the past; and the Lessee therefore agrees that she will at all times during the term of this lease, personally act and be known as the Principal of the school, and that she will at all times remain in actual personal charge, supervision and management thereof, fulfilling the duties usually incident to the position of principal of such a school, and that this lease nor any interest of Lessee in this lease shall not be hypothecated or assigned by her in whole or in part, nor shall it or any interest in it be assignable or transferable by operation of law, nor shall the premises or any portion thereof be sublet, and any

(Stipulation No. 3)

attempt to assign this lease in whole or in part, or any interest in this lease, or to sublet the premises or any part thereof, shall be wholly void. The Lessee shall not delegate her authority as principal to any other person, nor assign any of her rights under this lease.

As one of the principal motives inducing the Lessor to execute this lease is to insure, as far as possible, the continued operation of the school as in the past, and as both parties realize the necessity of always having available one who could, in case of the incapacity of the Lessee or termination of this lease, assume the duties of principal, the Lessee agrees that she will always endeavor to keep in her employ a woman who shall be known as the "vice principal" or "associate principal," and who shall perform the duties usually incident to the position of a vice principal in such a school, and who would be capable of undertaking the duties of principal and assuming the management of the school.

## VII.

### POLICIES—SALARIES—GENERAL EXPENSES— PERMANENT IMPROVEMENTS

It is understood that the Lessee, during the term of this lease, shall have the entire control and management of the school in all its branches and departments without interference by the Lessor; provided, however, that the Lessee shall not, without first obtaining the written consent of the Lessor, make any fundamental or material change in any existing policy or plan upon which the school is now being conducted, or any general change in the present scale of salaries paid to teachers in the school, or any change in the present method of conducting the

## (Stipulation No. 3)

school which would involve a material increase or decrease in the cost of conducting it, or any addition, alteration or permanent improvement to the premises, as distinguished from repairs and renewals incidental to upkeep. Provided further, that should any additions, alterations or improvements be required by any future laws, ordinances or governmental regulations, the same may be made without the written consent of the Lessor

## VIII.

## DEATH OR INCAPACITY OF LESSEE

Should the Lessee die, or should she for any reason (except by reason of temporary illness or incapacity lasting not more than six consecutive months) become incapacitated to such an extent that she shall not be able to personally perform her duties as principal and manage and conduct the school, then the Lessor may, at its option, immediately terminate this lease.

## IX.

## OPTION TO PURCHASE

Lessee shall have the right, on September 1st, 1940 or thereafter on the date of the expiration of any "period," during the continuance of this lease, to purchase the goodwill and right to use the name of the school, provided she is not in default hereunder and has paid all rental due Lessor, and provided she has given the Lessor at least six (6) months previous notice in writing of her intention to so purchase, upon paying to the Lessor the sum of Twenty-five Thousand and 00/100 Dollars (\$25,000.00) lawful money of the United States. Upon so purchasing the goodwill and the right to use the name, she shall immediately vacate the premises hereby leased and sur-



## (Stipulation No. 3)

render and deliver up the possession thereof to the Lessor, together with all furnishings and fittings therein or thereon which are the property of the Lessor, and thereupon this lease shall be terminated. Provided further, that at the time of giving notice of her intention to purchase the goodwill and right to use the name, the Lessee shall also have the right, at her option, to elect to purchase (in addition to the goodwill and right to use the name) the buildings on the premises and all the said furnishings and fittings; and should she elect so to do, the same shall, within six (6) months thereafter, (if the Lessor and Lessee cannot agree as to value) be appraised at their then reasonable value for removal, by a board of three appraisers, one to be selected by the Lessor, one by the Lessee, and the third by the two so selected. The appraisers shall certify their appraisal in writing to each party hereto. The decision of any two of the appraisers shall be binding upon both parties. On the date fixed by Lessee in her notice as the date on which she intends to purchase the goodwill, the Lessee shall pay (in addition to the purchase price of the goodwill and the right to use the name) as the purchase price of the buildings, the full appraised value thereof, and she shall pay as the purchase price of the furnishings and fittings fifty per cent (50%) of the appraised value of the whole thereof.

As soon as possible after purchasing the buildings and furniture and fittings, the Lessee shall cause the same to be removed from all the land, and shall also cause all holes and excavations to be filled with good earth and the land to be left in good order and condition. In removing the buildings care shall be taken as far as possible not to damage trees on the land.



## (Stipulation No. 3)

Should the Lessee purchase the good will and right to use the name, the Lessor agrees not to conduct or cause to be conducted any other girls' school of that name in the County of Los Angeles, California, so long as the Lessee, or any person deriving title to the goodwill from her, operates a girls' school in said County. Furthermore, the Lessor declares that it does not intend, in case it sells the goodwill, to conduct thereafter any school of that name at any place, and should the statutes of California hereafter be amended so as to permit of an agreement by one selling the goodwill of a business, not to carry on a like business within greater limits than a specified county, then the Lessor agrees that it will not, during said time, conduct or cause to be conducted a girls' school of that name within the greatest area as to which the law then permits such an agreement to be made. It is, however, understood that as the land hereby leased is restricted against use prior to 1950 for anything but residence purposes or a girls' school, nothing herein contained shall be construed as prohibiting the Lessor, after the purchase of the goodwill by the Lessee, from utilizing the premises hereby leased for a girls' school, provided the name "Marlborough School," or "Marlborough School for Girls," or some similar name, is not used, and provided that no attempt shall be made to draw off any of the pupils of Lessee or those deriving title to the goodwill from her.

## X.

## INSURANCE

During the term of this lease, the Lessee shall at all times keep the buildings, furnishings and fittings hereby

(Stipulation No. 3)

leased, and any renewals or additions thereto, insured against damage by fire, for at least the same amount, if obtainable, as now carried by Lessee, and shall also carry such other insurance, if obtainable, as is now carried in connection with the conduct of the school. Such insurance shall be written by companies approved by the Lessor and shall provide in effect that amounts which may become due thereunder in case of loss or damage by fire shall be payable to the Lessor, or if the property is mortgaged to the mortgagee. The cost of carrying such insurance shall be paid by the Lessee and chargeable as one of the expenses of conducting the school. Furthermore, should the parties hereto agree that other types of insurance should be carried, the cost thereof shall likewise be payable by the Lessee and chargeable as one of the expenses of conducting the school. Should the Lessee fail to cause insurance to be written and carried as herein provided, the Lessor may do so, and charge the cost thereof to the Lessee, which cost upon being paid by Lessee shall be chargeable as one of the expenses of the school. The Lessee agrees not to keep any materials on said premises, or do any act which will have the effect of voiding any fire insurance.

## XI.

### DAMAGE BY FIRE, ETC.

Should any of the property hereby leased be damaged at any time by fire, the Lessor agrees (excepting as hereinafter otherwise provided) to apply the amount of any fire insurance money received by it, or any mortgagee, in compensation for such damage, towards repairing the damage; but should the amount of fire insurance money

## (Stipulation No. 3)

received be insufficient to pay for the proper repairs and renewals, then the deficit shall be paid sixty per cent (60%) by the Lessor and forty per cent (40%) by the Lessee; provided, however, that as soon as the cost of repairing the damage is ascertained, and if it then appears that the cost will be in excess of the amount of insurance money which is to be applied towards repairing the damage, and if the Lessee is then unwilling to bear her said forty per cent (40%) of the excess, she may then elect to immediately terminate this lease; provided further, that should the main school building be so damaged by fire subsequent to September 1st, 1940, as to make it impractical to conduct the school and properly house and care for therein the pupils and teachers, then the Lessor shall, at its option, have the right to terminate this lease. In the event Lessor terminates this lease after September 1st, 1940 by reason of fire damage as aforesaid, Lessee shall, provided she is not then in default under this lease, have the right to purchase the goodwill, buildings and furnishings as given her by paragraph IX, within the period of six months from date of termination of this lease; provided Lessee shall, within thirty (30) days from receipt of notice from Lessor of such termination of this lease, give to the Lessor written notice of her intention to so purchase said goodwill, buildings and furnishings within said period.

Should the main school building be damaged at any time by earthquake, accident or by violent action of the elements (other than fire) to such an extent as to render it impractical to conduct the school and properly house and care for therein the teachers and pupils, then this lease shall immediately terminate and be at an end, and

(Stipulation No. 3)

Lessee shall have the right to at that time purchase the goodwill, buildings and furnishings as given her by paragraph XI, on giving to the Lessor the notice in this paragraph XI hereinabove specified; provided however, that if such damage is at the time covered by insurance against such damage to the extent of seventy-five per cent (75%) of the cost of repairing the damage, then the provisions above set forth in this paragraph XI as to applying the amount of fire insurance received towards the cost of rebuilding and sharing the additional cost, shall apply.

In the event that the buildings are so damaged by fire or other casualty that the school cannot be conducted and the pupils and teachers properly housed and cared for therein, then the Lessee shall be relieved of her obligation to pay the rental herein in paragraph IV provided for the period during which the school cannot be conducted therein.

\* \* \* \* \*

#### XIV.

#### LESSOR RETAKING POSSESSION— ACCOUNTING

Upon any termination of this lease because of the expiration of the term thereof, or under the provisions of Paragraph VIII because of the death or incapacity of the Lessee, or, under the provisions of Paragraph XI, because of fire, earthquake, etc., the Lessor shall have the right at its option to immediately enter into and take and

(Stipulation No. 3)

retain possession of all the property hereby leased and all furniture and fittings therein or thereon which are the property of Lessor, and at its option to immediately take over and retain the conduct, control and management of the school and all business and affairs incidental thereto, together with all money, accounts and bills receivable and other assets properly belonging or appertaining to the conduct of the school and its affairs; it being intended to so provide hereby that the Lessor shall have the right to step into the place and stead of the Lessee so far as concerns the conduct, business and affairs of the school, (the Lessor also assuming the liabilities for the "period" during which the lease is so terminated); provided however, that at the end of the "period" in which the lease is so terminated, the Lessor shall cause said accountants to audit the books and accounts for the "period," and as soon as said audit is completed shall pay to the Lessee, her executor or administrator (after deducting the amount due to the date of such termination on said rental provided in Paragraph IV hereof) such proportion of the Lessee's fifty per cent (50%) of the net profits for such "period" as the time from the beginning of the period to the date the lease is terminated bears to said fifty per cent (50%) of the net profits. But if, upon any termination of this lease the Lessee exercises her right to purchase the goodwill and right to use the name, then the conduct, control and management of the school and all its business and affairs, and all moneys, accounts and



(Stipulation No. 3)

bills receivable and other assets properly belonging or appertaining to the conduct of the school and its affairs (excepting the premises hereby leased and all furnishings and fittings therein or thereon which are the property of the Lessor) shall remain in the Lessee, and she shall cause the accountants to audit the books and accounts to determine the net profits, if any, for the last preceding "period," or fraction thereof, and upon the completion of the audit the Lessee shall pay to the Lessor its fifty per cent (50%) of said net profits, as shown by said audit.

\* \* \* \* \*

## XVII.

### INSPECTION BY LESSOR

The Lessor shall have the right to enter in and upon the premises at all reasonable times to inspect the condition thereof and of the furnishings and fittings.

In Witness Whereof, the parties herto have executed this lease on the date first above written, in duplicate.

MARLBOROUGH CORPORATION,

By Eugene Overton

President.

-----  
Lessor.

Ada S. Blake

Lessee.

[Endorsed]: Filed Sep. 25, 1945.

## [PLAINTIFF'S EXHIBIT NO. 1]

Policy Memo Re Reserve Fund.

It has been for many years and still is the purpose of the stockholders and directors of Marlborough Corporation to accumulate and establish a reserve fund in cash and/or liquid securities to provide for probable future business requirements and contingencies.

So far as can be foreseen at the present time, these probable business requirements and contingencies are believed to be as follows:

(1) Possible fire loss not compensated for by insurance, estimated at . . . . .	\$20,000.00
(2) Remodelling buildings in the event it is decided to eliminate the boarding department, and for other contingencies, estimated at . . . . .	15,000.00
(3) Additions to buildings, or new buildings that may be required, estimated at . . .	35,000.00
(4) To provide for working capital if the present lease on the School should be terminated . . . . .	50,000.00
(5) To provide for obsolescence and depreciation . . . . .	67,000.00
(6) To provide for earthquake damage, as no earthquake insurance is carried, estimated at . . . . .	20,000.00
(7) Indebtedness to Mark Overton, Georgia C. Overton and Eugene Overton . . .	35,500.00
	<hr/>
	242,500.00

(Plaintiff's Exhibit No. 1)

In order to gradually accumulate this reserve fund it is the policy to pay very moderate dividends until the reserve fund is established.

Eugene Overton

Georgia C. Overton

Case No. 3727-H Civil. Marlborough vs. U. S. A. Pltfs. Exhibit. Date Sep. 25, 1945. No. 1 in Evidence. Clerk, U. S. District Court, Sou. Dist. of Calif. E. N. Frankenberger, Deputy Clerk.

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[PLAINTIFF'S EXHIBIT NO. 2]

Policy Memo Re Reserve Fund.

November 7, 1939.

It has been for many years and still is the purpose of the directors of the Marlborough Corporation to accumulate a reserve fund in the form of cash and liquid securities of approximately \$215,000.00 to take care of estimated requirements as follows:

- (1) Possible fire loss not compensated for by insurance . . . . . \$ 20,000.00
- (2) Remodelling buildings in the event it is decided to eliminate the boarding department, and for other contingencies . . 15,000.00
- (3) Additions to buildings, or new buildings that may be required . . . . . 35,000.00

(Plaintiff's Exhibit No. 2)

(4) To provide for working capital if the present lease on the School should be terminated . . . . .	50,000.00
(5) To provide for obsolescence and depreciation . . . . .	75,000.00
(6) To provide for earthquake damage, as no earthquake insurance is carried . .	20,000.00
	<hr/>
	\$215,000.00

In order to gradually accumulate this reserve fund it is the policy to pay very moderate dividends until one-half of the reserve fund is built up, and thereafter, if profits warrant, to materially increase the dividends, but not in excess of one-half the profits, until the reserve fund is completed.

Eugene Overton  
President

Case No. 3727-H Civil. Marlborough vs. U. S. A.  
Pltfs. Exhibit. Date Sep. 25, 1945. No. 2 in Evidence.  
Clerk, U. S. District Court, Sou. Dist. of Calif. E. N.  
Frankenberger, Deputy Clerk.

[PLAINTIFF'S EXHIBIT NO 5—Identification]

Address Reply To  
"United States Attorney"  
and Refer to  
Initials and Number  
GMB:lm

Department of Justice  
UNITED STATES ATTORNEY  
Southern District of California  
Los Angeles 12

October 1, 1945

Edmund L. Smith, Clerk,  
U. S. District Court,  
Los Angeles 12, California.

Re: Marlborough Corporation v. United States  
No. 3727-H

Dear Mr. Smith:

Transmitted herewith is one copy of plaintiff's exhibit No. 5 for identification which has been photostated by the Department of Justice. The original has been returned to counsel for the plaintiff in accordance with the order of Judge Hollzer dated September 27, 1945.

Very truly yours,

CHARLES H. CARR,  
United States Attorney.

By George M. Bryant  
George M. Bryant,  
Assistant U. S. Attorney.



(Plaintiff's Exhibit No. 5—Identification)

Los Angeles, California

January 23rd, 1923

My Dear Georgia:

Herewith is a memorandum to supplement or complete my will which is in Fritz's possession. I hope to give during my life time a part of the legacies to Lucian and Nellie and Jennie, especially to Lucian. You will know, however, about this from time to time and will act accordingly.

I give this definite sum to Mark because I want him to feel that he has it for his very own. Under the circumstances, it will make no difference to you. It may be necessary to change the scale, but I think that there will be enough for everything.

I will at my leisure, make another memorandum of keepsakes that I would like given to others. If not, use your own judgment.

Mark Overton	\$20000
Lucian Knight	\$15000
Jennie Blanchard	\$ 5000
Nellie Blanchard	\$ 5000
Everett Smith	\$ 5000
Gordon Smith	\$ 5000
Nellie F. Moulton	\$ 2500
Ellen J. Flood	\$ 1000
Charles Hall	\$ 1000
Ellsworth Saunders	\$ 1000

Mary S. Caswell

Case No. 3727-H Civil. Marlborough vs. U. S. A. Pltfs. Exhibit. Date Sep. 27, 1945. No. 5 Identification. Clerk, U. S. District Court, Sou. Dist. of Calif. E. N. Frankenberger, Deputy Clerk.

[Endorsed]: Filed Oct. 3, 1945. Edmund L. Smith, Clerk.

## [DEFENDANT'S EXHIBIT B]

Expert Testimony a Specialty

VAndike 4078

"Over 8000 Appraisals in Southern California"

C. G. BROWN

Appraiser of Real Estate

426 South Spring Street

Los Angeles (13)

September 25, 1945.

Re Marlborough Corp. vs. United States

No. 3727-H

George M. Bryant, Esq.,

Assistant U. S. Attorney,

Los Angeles 12 Cal.

Dear Mr. Bryant:—

Herewith certain values pertaining to the Marlborough School for Girls, located at the northeast corner of Third and Roosmore, Los Angeles, as requested in your letter to me under date of September 24. As may be seen from above dates, I have not had time to make a regular, full-fledged appraisal and the figures given are therefore necessarily in the nature of preliminary ones. However, I do not surmise that, were final figures to be determined, they would vary greatly from those here used.

Question 1. Replacement cost of main building, fire-proof construction.

1st Floor,	280,000 Cu Ft at 50 cents.....	\$140,000.00
2nd "	170,840 Cu Ft 45 " .....	76,878.00
3rd "	49,000 " " 40 " .....	19,600.00
Basement	79,000 " " 25 " .....	19,750.00

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Total Value 1940 prices..... 256,228.00

Reduce 4 per cent to obtain 1939 value or \$245,000.00

(Defendant's Exhibit B)

Question 2. Reconstruction of plant at new location—fireproof.

	<u>1939.</u>	<u>1940.</u>
Main Building .....	\$245,000.00	\$256,228.00
Auditorium, 269,500 Cu Ft at 33 cents.....		88,935.00
Twelve—CLK—Dempsey Insert 10083 .. .. . dw “ Reduce 4 per cent for 1939 value.....	85,380.00	
Gymnasium. 63,000 Cu Ft at 35 cents ('40).....	20,000.00	21,050.00
Tennis Court 125 x 175', 22,000 sq ft.....	3,300.00	3,400.00 (15¢)
Other concrete, walks etc.	900.00	1,000.00
Garage .....	700.00	750.00
Landscaping and planting	3,500.00	4,000.00
Totals .....	<u>\$358,780.00</u>	<u>\$375,363.00</u>

Question 3. Land Value, R-1 Zone assumed.

712 Feet on Rossmore at \$80 per Front Ft.....	\$56,960.00
47 Feet on Third Street at \$70 per Front Ft.	3,290.00

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Total .....\$60,250.00

Question 4. Salvage Value of present buildings.

\$8,000.00 in 1939 and \$9,000.00 in 1940.

Question 5. Market Value of Land and Buildings “as is”.

\$135,000.00 in 1939. \$140,000.00 in 1940. August 31,  
both yrs.

Thanking you kindly for this opportunity to serve you,  
Very Respectfully,

C G Brown

C. G. Brown

CGB/mc

(Defendant's Exhibit B)

Case No. 3727-H Civil. Marlborough v. U. S. A. Defts. Exhibit. Date Sep. 26, 1945. No. B in Evidence. Clerk, U. S. District Court, Sou. Dist. of Calif. E. N. Frankenberger, Deputy Clerk.

[Endorsed]: No. 11881. United States Circuit Court of Appeals for the Ninth Circuit. Marlborough Corporation, Appellant, vs. United States of America, Appellee. Transcript of Record. Upon Appeal From the District Court of the United States for the Southern District of California, Central Division.

Filed March 11, 1948.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals for  
the Ninth Circuit

In the United States Circuit Court of Appeals  
for the Ninth Circuit

No. 11881

MARLBOROUGH CORPORATION,

Appellant,

v.

UNITED STATES OF AMERICA,

Appellee.

ORDER EXTENDING TIME FOR FILING THE  
RECORD AND DOCKETING THE ACTION  
IN THE APPELLATE COURT

Upon motion of appellant, consented to by appellee, and for good cause shown, the time for filing the record on appeal and docketing the action in this court is extended to Mar. 15, 1948.

Dated: January 23, 1948.

FRANCIS A. GARRECHT

Judge of the United States Circuit Court of Appeals for  
the Ninth Circuit

[Title of Circuit Court of Appeals and Cause]

MOTION FOR AN ORDER EXTENDING THE  
TIME FOR FILING TRANSCRIPT OF THE  
RECORD AND DOCKETING THE ACTION  
ON APPEAL UNDER RULE 73 OF FEDERAL  
RULES OF CIVIL PROCEDURE

Whereas, Notice of Appeal in the above cause was filed with the United States District Court, Southern District of California, Central Division, on November 25, 1947, and



Whereas, the trial court, by an order duly entered, extended the time for filing the record on appeal and docketing the action in the United States Circuit Court of Appeals, to February 3, 1948, and

Whereas, in an effort to abbreviate the record on appeal, counsel for the parties have been diligently engaged in the preparation of an agreed statement of the testimony before the trial court, and

Whereas, in order to join in such an agreed statement, counsel for defendant is required, by the rules of the Department of Justice, to submit such statement to his superior in Washington, D. C., for approval, which approval may require as much as sixty to ninety days to obtain, and

Whereas, considerable expense in printing the record on appeal may be saved and the issues on appeal clarified by such an agreed statement of the testimony;

Now, Therefore, counsel for the appellant moves the Court for an order, pursuant to Rule 13, of the Rules of the United States Circuit Court of Appeals for the Ninth Circuit, extending the time for filing the record on appeal and docketing this cause in the appellate court to May 3, 1948.

\* \* \* \* \*

Defendant consents to the foregoing motion.

\* \* \* \* \*

[Endorsed]: Filed Jan. 23, 1948. Re-filed Mar. 11, 1948. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause]

STIPULATION AND ORDER

It Is Stipulated by and between counsel for respective parties in the above proceeding that the Court shall consider as the record on appeal the printed record on appeal, plus such portions of the original exhibits transmitted by order of the District Court, dated March 5, 1948, as the parties may designate in their respective briefs.

Dated at Los Angeles, California, this 23d day of March, 1948.

\* \* \* \* \*

It Is So Ordered this 23d day of March, 1948.

CLIFTON MATHEWS

Judge

[Endorsed]: Filed Mar. 23, 1948, Paul P. O'Brien,  
Clerk.

[Title of Circuit Court of Appeals and Cause]

APPELLANT'S STATEMENTS OF POINTS ON  
WHICH IT INTENDS TO RELY ON APPEAL

Upon appeal in the above entitled cause, appellant intends to rely upon the following points:

(a) The trial court erred in finding and concluding that appellant corporation was a holding company, within the meaning of Section 102 of the applicable revenue laws, during the taxable years in question.

(b) Assuming the trial court was correct in holding that appellant was a holding company, within the meaning of Section 102 of the applicable revenue laws, during the taxable years in question, there was ample evidence in the record by way of stipulation, testimony and admitted exhibits, to overcome any prima facie effect that status as a holding company might have had on the ultimate question of a purpose to avoid surtaxes on appellant's shareholders.

(c) After refusing to admit evidence of the amounts expended by appellant in repairing and remodeling its school properties after resuming active conduct of the school in 1942, the trial court erred in basing its conclusions upon the finding that in 1946 appellant's school properties were in good repair and had not been substantially altered.

(d) That apart from any presumptions provided by law the trial court's Findings of Fact and Conclusions of Law were clearly erroneous in the light of the stipulated

evidence and the uncontradicted testimony of the witnesses.

(e) The trial court erred in concluding that appellant had not proved there was no purpose to avoid the imposition of surtax upon its shareholders.

(f) The trial court erred in concluding upon the evidence that appellant, in either the year ended August 31, 1939 or August 31, 1940, was availed of for the purpose of preventing the imposition of surtax upon income of its shareholders through the medium of permitting its earnings and profits to accumulate instead of being divided or distributed.

Dated: April 1, 1948.

\* \* \* \* \*

Service of the within Statements of Points upon which appellant intends to rely on appeal is acknowledged this 1st day of April, 1948.

\* \* \* \* \*

[Endorsed]: Filed Mar. 31, 1948. Paul P. O'Brien,  
Clerk.

